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LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT
ON
SET-OFF

LRC 97

July, 1988

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Canadian Cataloguing in Publication Data

Law Reform Commission of British Columbia.
Report on set-off

"LRC 97".
ISBN 0-7718-8696-9

1. Set-off and counterclaim - British Columbia.
I. Title.

KEB267.A72L385 1988 346.711'077 C88-092207-9

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TO THE HONOURABLE S.D. SMITH, Q.C.
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT ON
SET-OFF

When one person attempts to enforce payment of a debt owing to him by another, it is regarded as fundamentally fair that the second person should be entitled to have taken into account any money he is owed by the first. This is usually referred to as a right of set-off.

The modern law of set-off is a curiosity. It consists of legal and equitable principles formulated to overcome procedural problems and jurisdictional limitations which were resolved in 1873. The complexities of those principles serve no modern purpose, and obscure the underlying policies of the law to such a degree that they are frequently overlooked by modern courts. Following reforms late in the nineteenth century, it appeared that the law of set-off had largely been submerged in rights of counterclaim. More recently, courts have gone back to nineteenth century law to resolve modern problems, and have reinforced the distinctions between set-off and counterclaim. In this process, several important policies, namely that an assignee should be in no better position than his assignor, and that a broad right of set-off is available in situations of insolvency, have been overlooked or forgotten.

In this Report, recommendations are made to replace rights of set-off with revised rights of counterclaim.

CHAPTER I

INTRODUCTION

A. Counterclaim and Set-Off

When disputes arise between two people, each often has a claim against the other. Sometimes these claims are linked in some fashion. Perhaps they arose from the same transaction or course of dealings, or from a particular incident or event. In other cases, the claims are wholly unrelated.

As a practical matter, when people involved in litigation have claims against each other, it makes a good deal of sense to have the court hear their claims at the same time. For one reason, that is the most effective means of finally resolving the disputes between the parties. Any other approach involves the parties in continuing litigation and a multiplicity of proceedings.[1]

It is also an efficient approach. Less court time is likely to be involved if a number of claims are resolved in one trial, than if they are resolved in a series of trials.

Moreover, it is a realistic way of determining what must be done to resolve the disputes between the parties. One person's claim will cancel all or part of the other's. Why should B pay A $1000 if A owes him $1000? Allowing one party a judgment for the full amount he is owed, without taking into account obligations he owes in turn, is generally perceived to be unfair.

In British Columbia, the law permits a defendant to raise claims he is owed by the plaintiff in the proceeding commenced by the plaintiff. Two methods for doing this are available to the defendant: counterclaim and set-off. They are entirely different concepts.

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[1] One goal of the law is to avoid a multiplicity of proceedings between the parties. The *Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 10, provides:

> 10. The court, in the exercise of its jurisdiction in any cause or matter before it, shall grant, either absolutely or on reasonable conditions that to it seem just, all remedies any of the parties may appear to be entitled to in respect of any legal or equitable claim properly brought forward by them in the cause or matter so that, as far as possible, all matters in controversy between the parties may be completely and finally determined and all multiplicity of legal proceedings concerning any of the matters avoided.

B. Terminology

Before discussing counterclaim and set-off in any detail, it is useful to adopt a vocabulary to describe how they function. The plaintiff's claim will be referred to as the "principal demand." The defendant's claim will be referred to as the "cross demand." When the claims of the plaintiff and defendant are referred to collectively the term "cross demands" will be used. In the course of this Report, as it focuses on increasingly technical aspects of the law, we will continue to develop a vocabulary to assist in the discussion.

C. Counterclaim

Counterclaim is the modern procedure, if that designation is appropriate for a practice which dates from 1873, for bringing a cross demand in the plaintiff's action. The mechanics of counterclaim are very straightforward. Any cross demand can be brought by counterclaim.[2] If the cross demand is without merit, the plaintiff can apply to have it struck.[3] If the cross demand is inconvenient to hear at the same time as the plaintiff's claim, the court can order that it be tried separately.[4]

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[2] Rule 19(13) provides that:

> A defendant in an action may set-off or set up by way of counterclaim any right or claim, whether the set-off or counterclaim is for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

This reform was introduced in England in 1873: *Supreme Court of Judicature Act, 1873*, (U.K.) 36 & 37 Vict., c. 66, s. 24(3). (In this Report, this Act is referred to as the "*Judicature Act, 1873*.") That section is the predecessor of s. 6 of the *Law and Equity Act*, R.S.B.C. 1979, c. 224. The Judicature Commission recommended a more restricted right to counterclaim:

> We think, that a defendant, having a right or claim against a plaintiff with reference to the subject matter of the suit, or arising out of the same transaction, which at present he cannot enforce without a separate or cross action or suit, should be at liberty to bring forward such right or claim by his Answer, which, in that case, should have the same effect as if it were a Declaration in a cross action or suit, so as to enable the Court or a Judge to pronounce a final judgment between the parties with respect both to the original and to the cross demand. The same principle might, we think, be extended to the recovery of other demands of the defendant, capable of being set off against the plaintiff's demand, when the balance is in favour of the defendant. But a Judge should be empowered, on application by the plaintiff before trial, to refuse permission to allow such cross right or claim to be brought forward, if he shall be of opinion that it cannot conveniently be adjudicated upon in the case to be tried.

Judicature Commission, First Report (1869) 6-7.

Before the fusion of law and equity, courts had separate jurisdictions. Courts of common law could not grant equitable remedies. Courts of equity could not grant common law remedies. Equity responded by restraining common law proceedings on the principal demand until the defendant could proceed on his claim: *see infra*, Chapter II, n. 7. The *Common Law Procedure Act, 1854*, 17 & 18 Vict., c. 125, attempted to alter this state of law, with limited success, by conferring on common law courts the ability to recognize equitable defences. The Judicature Commissioners, for example, observed that:

> In the Common Law Courts...the jurisdiction...to grant injunctions and to allow equitable defences to be pleaded has been so limited and restricted, - the former extending only to cases where there has been an actual violation of the right, and the latter being confined to those equitable defences where the Court of Chancery would have granted a perpetual and unconditional injunction, - that these remedies have not been of much practical use at Common Law, and Suitors have consequently been obliged to resort to the Court of Chancery, as before, for the purpose of obtaining a complete remedy. (con't.)

It is important to understand what occurs when a defendant raises a cross demand against a plaintiff by counterclaim. Essentially, each party is bringing a separate proceeding.[5] For convenience, however, they are heard at the same time. Judgment is handed down on the plaintiff's claim. A separate judgment is handed down on the defendant's claim. An order for costs may be made for the plaintiff's proceeding, and another order for costs may be made for the defendant's counterclaim.

Perhaps the most admirable feature of counterclaim is its simplicity.

D. Set-Off

Rights of counterclaim were introduced late in the nineteenth century.[6] Before that time, procedural rules generally required the parties to bring their claims in separate proceedings. The only method by which a defendant could raise a cross demand against a plaintiff was as a set-off.

Set-off is based on the view that in some cases it is appropriate to look to the net effect of cross demands between parties, rather than to regard them as separate matters.[7] This

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2. (con't.)

> Much therefore of the old mischief still remains, notwithstanding the changes which have been introduced; and the Court of Chancery necessarily continues to exercise the jurisdiction of restraining actions at law on equitable grounds, and even claims to exercise that jurisdiction in cases where an equitable defence might be properly pleaded at Common Law.

Judicature Commission, First Report (1869) 11-12.

[3] See Rule 19(24)(a).

[4] Rule 21(13) provides:

> 21(13) Where, on the application of a party against whom a counterclaim is made, it appears that the subject matter of the counterclaim ought to be dealt with separately, the court may order the counterclaim be struck out or tried separately or may make such other order as it thinks just.

Rule 5(7) provides:

> 5(7) Where a counterclaim or a third party proceeding ought to be disposed of by a separate proceeding, the court may so order.

[5] *See, e.g.*, *Wells* v. *Russell*, [1952] O.W.N. 521 (C.A.); *Royal Bank of Canada* v. *Rizkalla*, (1984) 59 B.C.L.R. 324 (S.C.).

[6] Modern procedural rules are based on the reforms introduced by the *Judicature Act, 1873*, *supra*, n. 2.

[7] In *In re A Bankruptcy Notice (No. 171 of 1934)*, [1934] Ch. 431, 437, [1934] All E.R. 688, 692 *per* Lord Hanworth, approved in *Hanak* v. *Green*, [1958] 2 Q.B. 9 (C.A.), it was said that "set-off:" (con't.)

position is probably consistent with how most people see their dealings with others. A lawyer and an accountant may each provide the other with professional services and bill for them separately. Suppose the lawyer is owed $5000 and the accountant is owed $6000. In reality, the lawyer owes the accountant $1000, and a payment of that amount would be the simplest way of settling the accounts. For business purposes, however, in order to keep an accurate record of income and expenses, each will bill the other for the full amount owed, and each will pay the other in full.

Bookkeeping conventions designed to keep accountants and tax gatherers happy should not alter the substantive rights of the parties. The law is being realistic when it recognizes that the net position between the parties is the basis of their obligations to each other. We shall refer to the theory underlying rights of set-off as the "net basis" concept.

Complex rules determine what may be set-off. They are the product of legislation, as well as common law and equitable principles. The inter-play of these three sources of jurisdiction has led to a degree of confusion in the cases concerning exactly what may be set-off.

E. Overview of the Report

The two methods by which a defendant may raise a cross demand against a plaintiff function in entirely different fashions. Counterclaim is a simple procedural concept. It contemplates that parties who have cross demands which can be

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7. (con't.)

> ...is a word well known and established in its meaning; it is something which provides a defence because the nature and quality of the sum so relied upon are such that it is a sum which is proper to be dealt with as diminishing the claim which is made, and against which the sum so demanded can be set off.

In *Federal Commerce and Navigation Ltd.* v. *Molena Alpha Inc.*, [1978] 1 Q.B. 927, 974, [1978] 3 All E.R. 1066, 1077 (C.A.) *per* Lord Denning, it was said:

> Again take the case where the contract gives a creditor a right to take the law into his own hands, to take a particular course of action if a sum is not paid: such as to forfeit a lease for non-payment of rent, or to withdraw a vessel for non-payment of hire. There the distinction between set-off and cross-claim is crucial. When the debtor has a true set-off it goes in reduction of the sums owing to the creditor. If the creditor does not allow it to be deducted, he is in peril. He will be liable in damages if he exercises his contractual right of withdrawal wrongly.

In *B.J.C.C.* v. *Burndy Corp.*, [1985] 1 All E.R. 417, 427 (C.A.) it was said:

> The essence of an equitable set-off is that equity considered it unjust that a claimant should seek to enforce a claim without giving credit for a related cross-claim which the defendant had against him.

heard separately may be heard in the same proceeding. Set-off is an exceedingly technical defence. It allows cross demands between parties to be heard in the same proceedings when the obligations of the parties should be resolved on a net basis.

It may be questioned whether there is a need for two methods of raising a cross demand. The nineteenth century reforms which led to the creation of counterclaim were aimed at reducing the number of procedural options open to litigants, in order to simplify the process of litigation and avoid procedural traps.[8] In terms of principle, it would appear that there should be only one method of raising a cross demand.

In this Report, we examine set-off to determine how well this ancient concept operates in modern law and why it survived the introduction of rights of counterclaim.

This Report was preceded by a Working Paper which was circulated widely for comment. Responses received on the Working Paper will be referred to later in this Report.

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[8] *Supra*, nn. 1 and 2.

CHAPTER II SET-OFF

A. Introduction

Use of the term "set-off" suggests that it is a single concept. In fact, set-off embraces three distinct situations where a defendant may raise a cross demand against a plaintiff's claim: statutory set-off, abatement and equitable set-off. The three aspects of set-off are supported by the same policy. However, they developed separately and continue to be applied as separate concepts by modern courts.

B. Set-Off When the Parties Are Solvent

Historically, different rules of set-off were applied depending upon whether one of the parties was insolvent. In British Columbia, the law no longer seems to draw a distinction on this basis. The principles applied by nineteenth century courts when none of the parties was insolvent seem today to be applied in all situations of set-off. The "non-insolvency" principles of set-off are discussed in this section.

1. LEGISLATION

In 1729, legislation was enacted in England which permitted the set-off of "mutual debts."[1] This legislation is part of the received law of British Columbia.[2] When a plaintiff sues to recover a debt, the defendant may set-off a debt the plaintiff owes him. This legislation, however, does not apply when one of the parties has a claim for something other than debt. For example, if the plaintiff sues for damages (the "principal demand"), the defendant cannot set-off a debt. Similarly, if the plaintiff sues for debt, the defendant cannot set-off a claim for damages.[3]

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[1] A series of statutes allowed set-off where each party's claim was for debt. The first of these statutes was An Act for the Relief of Debtors with respect to the Imprisonment of their Persons, (U.K.) 1729, 2 Geo. II, c. 22, s. 13, which provided:

> And be it further enacted by the authority aforesaid, That where there are mutual Debts between the Plaintiff and Defendant, or if either Party sue or be sued as Executor or Administrator, where there are mutual Debts between the Testator or Intestate and either Party, one Debt may be set against the other, and such Matter may be given in Evidence upon the General Issue, or pleaded in Bar, as the Nature of the Case shall require, so as at the Time of his pleading the General Issue, where any such Debt of the Plaintiff, his Testator or Intestate, is intended to be insisted on in Evidence, Notice shall be given of the particular Sum or Debt so intended to be insisted on, and upon what Account it became due, or otherwise such Matter shall not be allowed in Evidence upon such General Issue.

Section 13 was made perpetual in An Act to explain and amend an Act passed in the second Year of the Reign of his present Majesty, intituled, *An Act for the Relief of Debtors with respect to the Imprisonment of their Persons*, (U.K.) 1735, 8 Geo. II, c. 24, s. 4. A third statute, An Act for explaining and amending an Act made in the last Session of Parliament, intituled, *An Act for the Relief of Debtors with respect to the Imprisonment of their Persons*, (U.K.) 1730, 3 Geo. II, c. 27, is a companion piece of legislation to the first two Acts, but did not further alter statutory set-off. These statutes are collectively referred to in this Report as the Statutes of Set-off.

[2] In *Canadian Imperial Bank of Commerce* v. *Tuckerr Industries Inc.*, (1983) 149 D.L.R. (3d) 172, 174, 46 B.C.L.R. 8, 10 (B.C.C.A.) Lambert J.A. notes that the Statutes of Set-off are part of the received law of British Columbia; *see also Pos* v. *Pos*, (1985) 61 B.C.L.R. 388 (S.C.); *contra Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*, (1915) 8 W.W.R. 1124 (B.C.C.A.). The law of set-off is not uniform across Canada. (con't.)

Only mutual debts may be set-off under the legislation. The requirement for mutuality has been interpreted as requiring two conditions be satisfied to permit set-off: the debts must be of the same nature[4] and they must be due to and from the same parties in the same capacities.[5]

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2. (con't.) Some provinces such as British Columbia, rely on the Statutes of Set-off and the common law while others have statutory provisions on set-off: *see, e.g., Courts of Justice Act, 1984*, S.O. 1984, c. 11, s. 124; *The Queens Bench Act*, R.S.M. 1970, c. C280, ss. 78-9. Other provinces appear to rely on the Statutes of Set-off and on the common law. In New Brunswick, *The Supreme Court Act*, C.S.N.B., 1903, c. 111, ss. 117-118 provided for a right of set-off:

> 117. A defendant in any action may set-off against the claim of the plaintiff any right or claim whether such set-off sound in damages or not.
>
> 118. Such set-off shall have the same effect as if relief were sought in a cross action and so as to enable the Court to pronounce a final judgment in the same action, both on the original and on the cross claim.

The Supreme Court Act was repealed by *The Judicature Act, 1909*, S.N.B. 1909, c. 5. While these modern statements tend to adopt the concept of mutual debts between parties, some jurisdictions such as Ontario, allow a set-off where the debts may not be owed by or to the person in the same capacity. The Ontario *Courts of Justice Act, 1984, supra*, s. 124(2) provides that:

> Mutual debts may be set off against each other, notwithstanding that they are of a different nature or that one debt is owed to or by a person in a personal capacity and the other debt is owed by or to the person in a capacity other than personal.

See also infra, nn. 4 and 5.

[3] *Halsbury's Laws of England*, (4th ed.) vol. 42, 246, para. 421, summarizes the scope of the right to statutory set-off as follows:

> The right conferred by the Statutes of Set-off was a right to set off mutual debts arising from transactions of a different nature which could be ascertained with certainty at the time of pleading. Thus, no legal set-off could exist against a claim which sounded in damages, nor could a claim which sounded in damages be set off at law against a plaintiff's claim. The fact that a claim was framed in damages precluded the raising of a set-off at law, notwithstanding that the claim might have been differently framed in a way which would have permitted such a set-off. Where a claim for a liquidated debt was joined by a plaintiff with a claim for damages, set-off at law might only be pleaded in defence to the former claim.

[4] The concept of mutual debts seems to have always caused confusion: *see, e.g., In re Whitehouse & Co.*, (1878) 9 Ch. D. 595, 597 (C.A.). The law formerly distinguished between different kinds of liquidated demands. A simple debt was treated differently from a specialty debt (a bond, mortgage or debt secured by writing under seal) and from penalties. Joint debts were treated differently from several debts and debts owed jointly and severally. Few of these distinctions hold any modern significance. The modern law has developed so that specialty debts, for the most part, are accorded the same status as simple debts. Penalties continue to be treated differently from liquidated demands. The special status of joint debts will end when recommendations made in *Report on Shared Liability* (LRC 88, 1986) are implemented; *see, e.g., Middleton v. Pollock*, (1875) L.R. 20 Eq. 515; note also that a joint debt can be set off against a separate debt, if incurred in consideration of the separate debt: *Vulliamy v. Noble*, (1817) 3 Mer. 593, 617, 618, 36 E.R. 228, 237; *see also Bradley v. Millar*, (1812) 1 Rose 273. The ambiguity over the reference to "mutual debts" was resolved by the third Statute of Set-Off, (1735) 8 Geo. II, c. 24, s. 5: (con't.)

The requirement for mutuality has led to a great deal of confusion, most particularly in situations involving an assignment.

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4. (con't.)

> ...That by virtue of the said Clause...mutual Debts may be set against each other, either by being pleaded in Bar, or given in Evidence on the General Issue, in the Manner therein mentioned, notwithstanding that such Debts are deemed in Law to be of a different Nature; unless in Cases where either of the said Debts shall accrue by reason of a Penalty contained in any Bond or Specialty; and in all Cases where either the Debt for which the Action hath been or shall be brought, or the Debt intended to be set against the same hath accrued, or shall accrue, by reason of any such Penalty, the Debt intended to be set off, shall be pleaded in Bar, in which Plea shall be shewn how much is truly and justly due on either Side; and in case the Plaintiff shall recover in any such Action or Suit, Judgment shall be entered for no more than shall appear to be truly and justly due to the Plaintiff, after one Debt being set against the other as aforesaid.

See Tidds Practice (9th ed., 1828) vol. I, 663. The term, "mutual debts," however, continues to be used and causes confusion to this day. Today the term is confined generally to mean liquidated demands. Mutuality is defined as "debts due from either party to the other for liquidated sums, or money demands which can be ascertained with certainty at the time of pleading": *Royal Trust Co.* v. *Holden*, [1915] 8 W.W.R. 500 (B.C.C.A.) citing *Bennet* v. *White*, [1910] 2 K.B. 643, 646 (C.A.). But where one debt is paid for a particular purpose there is no mutual credit or debt: *In re Pollitt; Ex P. Minor*, [1893] 1 Q.B. 455, 62 L.J.Q.B. 236 (C..A.); *Royal Trust Co.* v. *Holden*, *supra*; *In re Mid-Kent Fruit Factory*, [1896] 1 Ch. 567.

5. Like the first condition, the capacities of the parties has proved to be a perplexing concept. Before set-off is available, there must be cross demands between two persons. In a few cases, a person may owe and be owed obligations in different capacities, hence the requirement for mutuality. If, for example, B owes A a sum of money and A, as trustee for C, owes B a sum of money, set-off is not available, since the cross demands involve A in two different capacities: *Whitaker* v. *Rush*, (1761) Amb. 407, 27 E.R. 272; *see also*, *e.g.*, *McMahon* v. *Canada Permanent Trust Co.*, (1980) 17 B.C.L.R. 193, 197 (C.A.); *Miller Contracting Ltd.* v. *Smith*, [1985] B.C.D. Civ. 943-04 (S.C.); *In re Whitehouse & Co.*, *ibid.* This aspect of the concept of mutuality, however, is being applied by some modern courts in order to distinguish between the position that applies depending upon whether the principal demand is brought by the party originally entitled to enforce it or by a successor in interest. Modern courts have adopted the view that once a debt is assigned, mutuality is lost: *Tuckerr Industries Inc.*, *supra*, n. 2; *Rapid Data Systems & Equipment Ltd* v. *Government of Canada*, (1978) 23 N.R. 54 (F.C.A.); *Lynch* v. *Ardmore Studios (Ireland) Ltd.*, [1966] I.R. 133; *Holt* v. *Telford*, *infra*, Chapter V, n. 1. If mutuality is lost by assignment, then set-off is no longer available under the Statutes of Set-off. In these circumstances, if a cross demand is to be set-off, it must qualify as an equitable set-off: *infra*, Chapter II, B, 3; *see also infra*, n. 7. In the nineteenth century, however, when a successor in interest became entitled to enforce a demand, no change of capacity was considered to have occurred: *Roxburghe* v. *Cox*, (1881) 17 Ch. D. 520, 526. What has been lost sight of is that before the fusion of the courts of common law and equity in 1873, whether the demand could be set-off under the Statutes of Set-off depended on whether the proceedings were in a court of equity or common law. If there was an assignment, which court had jurisdiction depended on the nature of the assignment and the nature of the assigned claim. If an assignee brought his claim in a court of common law, it was brought in the name of the assignor. Clearly, in such a case there was "no loss of mutuality" and the Statutes of Set-off were applicable. If the assignee brought his claim in a court of equity, a liquidated demand could be set-off against a liquidated demand by analogy to the Statutes of Set-off. Where the assignee was permitted to sue on an assigned claim, equity permitted all defences to be raised as if the assignee were the assignor. In *Touche Ross Ltd.* v. *Alberta Mortgage and Housing Corp.*, Alberta Judgments: [1987] A.J. No. Action No. 8501-05740 (Alta. Q.B.) March 25, 1987, relying on *Aboussafy* v. *Abacus Cities Ltd.*, (1981) 124 D.L.R. (3d) 150 (Alta. C.A.), it was said that unrelated liquidated demands could not be set off in equity. This, in terms of the law, is a fundamental error: *see*, *e.g.*, *Peters* v. *Soame*, (1701) 2 Vern. 428, 23 E.R. 874; *Curson* v. *African Co.*, (1682) 1 Vern. 121, 23 E.R. 358. It was only when one or both of the demands was unliquidated, that equity required some connection between the cross demands for set-off to be allowed: *Whitaker* v. *Rush*, *supra*, at 273, citing *Downam* v. *Matthews*, (1721) Prec. Ch. 580, 24 E.R. 260, and even then, the degree of connection between the cross demands was not critical. *See also* Story, *Commentaries on Equity Jurisprudence*, (13th ed., 1886) vol. II, 767-8. (con't.)

2. SET-OFF AT COMMON LAW

Before 1873, the courts administered two basic bodies of law: common law and equity. A court of common law had a separate jurisdiction from a court of equity.

The courts of common law would permit set-off in only a few situations. Set-off recognized by common law courts was called "abatement," such as abatement of rent, abatement of the sum due for work and labour done, and abatement of the price of goods sold and delivered.[6] For example, if A purchased defective goods from B, A would not be able to claim damages for breach of contract in a proceeding brought by B for the purchase price. He would, however, be able to raise the defects in the goods as a defence to such an action, as an abatement to diminish the value recoverable.

Abatement does not figure prominently in the current law. It has been largely overtaken by the principles of set-off developed by the courts of equity.

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5. (con't.) Methods used by nineteenth century courts to ensure that no distinction was drawn between assignee and assignor are being used by twentieth century courts to emphasize the distinctions between them. Hence, the suggestion in *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14 (B.C.C.A.) that circumstances of equitable set-off will be rare, and the suggestion in *Tuckerr Industries Inc.*, *supra*, that statutory set-off is not available once there is an assignment. The requirement that cross demands must be in the same right or capacity arises in other contexts of the law and, curiously, causes little difficulty; *e.g.*, a defendant's ability to raise a cross demand by counterclaim is subject to that requirement. If a plaintiff brings an action as a trustee, a defendant will not be able to raise a counterclaim against the plaintiff in his personal capacity. Similarly, a judgment creditor with a judgment against B may not execute upon property B holds in trust for another. The law of set-off need not be expressed in terms of a need for mutuality. Mutuality of parties serves no purpose that is not adequately performed by the concept of cross demands in existence before the assignment is completed. Ontario attempted to address this problem by providing that mutuality exists where:

> ...one debt is owed to or by a person in a personal capacity and the other debt is owed by or to the person in a capacity other than personal.

Courts of Justice Act, 1984, S.O. 1984, c. 11, s. 124(2). This would appear to provide that set-off is available where a person is owed a debt in his own right, but owes a debt as a trustee. It is difficult to see any justification for permitting set-off in that situation. This section, however, does not seem to have caused problems: *see, e.g.*, *Richardson* v. *Richardson*, (1986) 1 R.F.L. (3d) 67 (Ont. C.A.).

6. *Federal Commerce and Navigation Ltd.* v. *Molena Alpha Inc.*, [1978] Q.B. 927, 974, [1978] 3 All E.R. 1066, 1077 (C.A.). With only a few exceptions, the common law courts viewed cross demands as separate matters: *Green* v. *Farmer*, (1768) 4 Burr. 2214, 98 E.R. 154. Cross demands arising from a single transaction might be joined in the same action, but only where one party's claim constituted a defence to the other party's claim: *see Allen* v. *Cameron*, (1833) 1 C. & M. 832, 149 E.R. 635; *Mondel* v. *Steel*, (1841) 8 M. & W. 858, 151 E.R. 1288; *Sale of Goods Act*, R.S.B.C. 1979, c. 370, s. 56(1). In the case of *Young* v. *Kitchin*, (1878) 3 Ex. D. 127, the plaintiff was assignee of the debt due under a building contract. The defendant alleged that there were breaches of the contract and that he should be entitled to set-off damages against the debt assigned. The debt, the court concluded, was assigned subject to the equities in existence at the time of notice of the assignment to the debtor and allowed the cross demands to be set-off. Statutory set-off was unavailable because the defendant's claim was for an unliquidated amount. This decision is regarded as seminal with respect to rights of set-off on an assignment. It might more properly be characterized as a situation of abatement. Logically, however, the abatement cases should be subsumed as part of the law of set-off and counterclaim.

3. Set-Off In Equity

Equity allows a set-off whenever there is "an equity to intervene."[7] This test has never been defined with any degree of particularity.

Spry describes equitable set-off as follows:[8]

> What generally must be established is a relationship between the respective claims of the parties which is such that the claim of the defendant has been brought about by, or has been contributed to by, or is otherwise closely bound up with, the rights that are relied on by the plaintiff and which is such that it would be unconscionable that he should proceed without permitting a set-off.

Modern courts tend to determine whether set-off in equity is allowed by reference to whether the cross demands arise from transactions that are sufficiently related.[9]

(a) Set-Off Between Original Parties

At one time, equity appears to have distinguished between set-off between the original parties, and set-off against an assignee. When the original parties were involved, a stricter test than related transactions was applied. The defendant's cross demand had to impeach the plaintiff's demand in some way.

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[7] *Hanak* v. *Green*, [1958] 2 Q.B. 9, 18-9 (C.A.); *Aries Tanker Corp.* v. *Total Transport Ltd.*, [1977] 1 W.L.R. 185, 191, [1977] 1 All E.R. 398, 404-5, (H.L.) *per* Lord Wilberforce:

> One thing is certainly clear about the doctrine of equitable set-off - complicated though it may have become from its involvement with procedural matters - namely, that for it to apply, there must be some equity, some ground for equitable intervention, other than the mere existence of a cross-claim.

Equity would permit a cross demand to be set-off in two situations. Where a court of equity had jurisdiction, it would allow a liquidated demand to be set-off against a liquidated demand, by analogy to the Statutes of Set-Off. Where one or both demands were unliquidated, equity would permit a set-off if there was an equity to intervene. The procedure by which set-off in equity was applied embraced the equitable remedies of injunction and account: *Rawson* v. *Samuel*, (1841) Cr. & Ph. 161, 41 E.R. 451; *Clark* v. *Cort*, (1840) Cr. & Ph. 154, 41 E.R. 449. Once an action at law was commenced against which a cross-demand could be established, the defendant could file a bill in equity requesting an injunction restraining the action from proceeding. If sufficient equitable grounds for relief were found, the court would issue either an interim or perpetual injunction. An interim injunction would issue where a temporary halt to the proceedings at law was required. During the stay, a cross demand could be pursued at law. Alternatively, an account might be taken in equity and the balance thus determined set off against the amount recovered in the action at law: *Rawson* v. *Samuel*, *supra*, at 177-9 (Cr. & Ph.), 458 (E.R.). A perpetual injunction would issue where the plaintiff at law was found to have no claim against the defendant: *e.g.*, in circumstances of fraud, or where the cross-demand exceeded the principal demand: *Ex p. Stephens*, (1805) 11 Ves. Jun. 24, 32 E.R. 996. A defendant who established a claim in equity, in excess of the plaintiff's claim at law, was not able to recover the surplus under equity's jurisdiction. Thus, set-off in equity came to be understood as a plea in bar to the plaintiff's action at law. Equity would also restrain, where necessary, a judgment from proceeding to execution until a cross-demand had been determined: *Rawson* v. *Samuel*, *supra*. But terms could be imposed upon the applicant for the injunction. For example, a stay of execution on a judgment might be granted to an applicant upon payment of the amount of judgment into court pending the cross-claim. *See also* Smith, *An Analysis of Smith's Principles of Equity*, (4th ed., 1909) 144. After the *Judicature Act, 1873*, when a single court could administer both common law and equity, these procedures were no longer necessary. Set-off could take place in the same proceeding. It is important, however, to keep in mind the procedure discussed above when reading cases concerning equitable set-off before 1873.

[8] Spry, *Equitable Remedies*, (3rd ed., 1984) 175.

[9] *Holt* v. *Telford*, *infra*, Chapter V, n. 1.

(b) Set-Off Against an Assignee

Against an assignee, however, a defendant had only to establish that the cross demands were sufficiently related or so connected that in "all the circumstances of the case...an equity is made out for blending the two matters together."[10]

The modern law appears to have adopted the less strict test applied to assignments in all cases involving set-off in equity.[11]

C. Set-Off When the Parties Are Insolvent

In England, rights of set-off were initially recognized when one party was insolvent.[12] The first legislation which

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10. *Rennick* v. *Bender*, [1924] 1 W.W.R. 270, 276 (Sask. K.B.); *see also Dodd* v. *Lydall*, (1842) 1 Hare 333, 337-8, 66 E.R. 1060, 1062; *Rawson* v. *Samuel*, *supra*, n. 7. An assignment is subject to the "equities," a more flexible concept than set-off between the original parties. A defendant's cross demand could be set-off if it was in some way related or connected to the assigned demand.

11. *Hanak* v. *Green*, *supra*, n. 7. *See*, however, Spry, *supra*, n. 8, 177; Spry, "Equitable Set-offs," (1969) 43 Aust. L.J. 265, 270; *see also* Law Reform Committee of South Australia, *Relating to the Reform of the Law of Set-off*, (75th Report, 1983) 7. In *Hanak* v. *Green*, *supra*, the principal demand was for breach of a building contract. The defendant's cross demand was for breach of the building contract, payment for additional work and trespass to the defendant's property by detention of tools. Statutory set-off was unavailable since the cross demands were not debts but, since the cross demands arose from the same transaction, they could be set-off in equity. Several of the claims which were set-off, however, did not impeach the contract upon which the plaintiff was suing. The basis of equitable set-off is that there must be an equity to intervene, a requirement that the court in *Hanak* v. *Green* appears to have overlooked. Some modern courts apply the test developed between original parties to cases of assignment: *See, e.g.*, *Aboussafy*, *supra*, n. 5. Other modern courts apply the test developed in cases of assignment to set-off between original parties, as in *Hanak* v. *Green*, *supra*. Much of the confusion may be traced to the reaction of the common law courts to the reforms introduced by the *Common Law Procedure Act, 1854*, (U.K.) 17 & 18 Vict., c. 125, ss. 83-6: *supra*, Chapter I, n. 2. The common law courts interpreted the legislation as restricting their ability to recognize equitable defences, such as set-off, to those circumstances where equity would grant a permanent injunction. Common law courts, consequently, would not recognize equitable defences which would support a temporary injunction: *see, e.g.*, *Wodehouse* v. *Farebrother*, (1855) 5 El. & Bl. 277, 288-9, 119 E.R. 485, 489; *Sovereign Life Assurance Co.* v. *Dodd*, (1892) 2 Q.B. 573, 578 (C.A.). It has also been suggested that the two approaches, one which requires no more than a sufficient connection between the claims, the other which requires the cross demand to impeach the principal demand, are both derived from the same case, *Rawson* v. *Samuel*, *supra*, n. 7. In that case, the test supporting equitable set-off was formulated in terms of "impeachment," a term which suggests the stricter of the two tests was intended. However, "impeachment" was frequently used in Chancery pleading at this time although no technical meaning seems to have been assigned to it. Consequently, the more liberal of the tests is also defensible, particularly when authority earlier than *Rawson* v. *Samuel* is considered: J.H. Farrar, *Working Paper on the Law of Set-Off*, (1980) 8-9, prepared for the Contracts and Commercial Law Reform Committee, Department of Justice, New Zealand; *see also Colonial Bank* v. *European Grain Ltd.*, [1988] 3 W.L.R. 60, 76 (C.A.).

12. (1705) 4 & 5 Anne, c. 17; (1718) 5 Geo. 1, c. 24. Early decisions indicate that equity was concerned about an unfair advantage being obtained by one party against another, where a new party stood in place of an original party to the action.

(con't.)

permitted rights of set-off was enacted in 1705. It provided that cross demands between an insolvent and another party must be set-off. Any claim an insolvent had against another could be reduced by a cross demand provable in the bankruptcy. Rights of set-off, consequently, were much broader in a bankruptcy than when the parties remained solvent.[13]

It is a matter of some importance whether set-off is available when one party is insolvent. If set-off is not available, the likelihood is that the cross demand will never be satisfied.

In British Columbia, legislation identical to the English legislation was adopted,[14] but this was repealed when federal bankruptcy legislation was enacted in 1875.[15] The section of *The Insolvent Act of 1875* that provided for rights of set-off has been carried forward into the current *Bankruptcy Act*:

> 75. (3) The law of set-off applies to all claims made against the estate and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except insofar as any claim for set-off is affected by the provisions of this Act respecting frauds or fraudulent preferences.

This section is interpreted as referring to the law of set-off of the province in which the application for set-off is

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12. (con't.) *See Peters* v. *Soame*, *supra*, n. 5; *Chapman* v. *Derby*, (1869) 2 Vern. 117, 23 E.R. 684, 685 where Lord Hale said that a debtor should only "answer to the bankrupt's estate the balance of the account." *Jeffs* v. *Wood*, (1723) 2 P. Wms. 128, 130, 24 E.R. 668, 669.

13. Set-off in bankruptcy, until modern times, never involved the considerations respecting intrinsically related cross demands applied in the context of equitable set-off. Liquidated and unliquidated demands arising from the dealings between a person and the bankrupt could be set-off: *Halsbury's Laws of England* (4th ed.) vol. 3 para. 751 *et seq.*; *Mersey Steel and Iron Co.* v. *Naylor, Benzon & Co.*, (1882) 9 Q.B.D. 648 (C.A.), (1884) 9 App. Cas. 434 (H.L.). It would appear, however, that unliquidated demands based on tort were excluded claims in bankruptcy: *see* Gower, *Modern Company Law* (4th ed., 1979) 730-31; *Halsbury's*, *supra*, at para. 751; *Tilley* v. *Bowman, Ltd.*, [1910] 1 K.B. 745.

14. The English bankruptcy legislation, including the rules relating to set-off in bankruptcy, were confirmed as the law of bankruptcy and insolvency in the Colony of Vancouver Island and in the Colony of British Columbia: *see* R.S.B.C. 1871, No. 6 (particularly ss. 1 and 109), and No. 59, s. 1.

15. *The Insolvent Act of 1875*, S.C. 1875, c. 16, s. 107, was based in turn on *The Insolvent Act of 1864*, S.C. 1864, c. 17, a statute of Upper Canada. It is framed more narrowly than the English legislation of 1705, but would appear not to have been intended to narrow the principles of set-off in bankruptcy: *see, e.g.*, W.F. Hamilton, *Company Law* (3rd ed., Can. 1911) 492 *et seq.* An identical provision was adopted for liquidations under the federal *Winding-Up Act*, R.S.C. 1970, Chap. W-10, s. 73. Both the bankruptcy and the liquidation provision were construed as referring to provincial legislation: *see, e.g.*, *The Liquidators of the Maritime Bank of the Dominion of Canada Under the Winding-Up Act* v. *Troop*, (1889) 13 S.C.R. 456, 464, where the legislation was construed by reference to the first Statute of Set-off; and *Crain* v. *Wade*, (1917) 55 S.C.R. 208, where the legislation was construed by reference to contemporary Ontario legislation restating the first Statute of Set-off. The argument was not made that English bankruptcy legislation was a more appropriate guide.

made.[16] In bankruptcy situations, however, the courts apply principles of set-off that were formulated in a non-bankruptcy context by English courts in the eighteenth and nineteenth centuries. It is surprising that the principles of set-off developed in bankruptcy are not applied. It is likely that this is largely due to historical oversight.

D. Set-Off by Agreement

It is open to the parties to agree, expressly or tacitly, that particular cross demands may be set-off.[17] When such an agreement exists, the courts need not determine whether set-off is available at common law, in equity or under legislation.

E. Summary

One can see in the law a tendency to synthesize set-off into a single set of principles. Distinctions formerly drawn between set-off against an assignee and set-off against an original party have been blurred. Similarly, distinctions between set-off against a solvent party and against an insolvent party are no longer drawn. Nevertheless, it is surprising that the law must be stated with so much complexity.

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[16] *Ibid., see also Re Merker*, (1985) 54 C.B.R. 153 (Ont. S.C.); *Coopers & Lybrand Ltd.* v. *Lumberland Building Materials Ltd.*, (1983) 49 B.C.L.R. 239 (S.C.). It is difficult to say with any certainty how set-off operates in bankruptcy. Section 75(3) speaks of "all claims made against the estate." Under the *Bankruptcy Act*, a claim may be for a liquidated or unliquidated amount. If the claim is unliquidated, the claimant must proceed separately to establish the claim, but the court's order can be made without prejudice to rights of set-off: *Re Malkin*, (1922) 22 O.W.N. 330 (S.C. in Bankruptcy). Once a claim is assessed it is liquidated and, presumably, it may be set-off as a mutual debt. If this position is correct, then the law of set-off is broader in bankruptcy than in non-insolvency cases. Canadian cases dealing with set-off in the context of bankruptcy, however, are not rigorous, and it is difficult to state any proposition with conviction. Moreover, the proviso that set-off is subject to the provisions of the Act dealing with fraudulent preferences further complicates the matter. In some cases, it seems that any set-off would be regarded as a fraudulent preference in the sense that it prefers a person who has a claim against the bankrupt's estate: *see, e.g., Re Hank Tenwolde Construction Ltd.*, (1981) 37 C.B.R. 223 (N.S.S.C.,T.D.), but this cannot be correct. First, whether a fraudulent preference exists at all depends upon the intention of both parties to prefer the creditor. When a creditor resists another's claim on the basis of set-off there can be no concurrent intention. Moreover, set-off determines the amount which is owed between parties. It is, consequently, incorrect to characterize a set-off as a payment which might qualify as a fraudulent preference. Lastly, it is important to distinguish between rights of account and of set-off. An accounting clearly determines the net balance between a creditor and debtor, and again it is inappropriate to characterize this process as a fraudulent preference: *see, e.g., Halesowen Presswork & Assemblies Ltd.* v. *National Westminster Bank Ltd.*, [1971] 1 Q.B. 1, 46, *per* Buckley, L.J.

[17] *Infra*, Chapter V, n. 4. Moreover, in some cases, the conduct of a party will estop him from relying on a set-off: *Higgs* v. *Northern Assam Tea Co.*, (1869) L.R. 4 Ex. 387; *In re Hercules Insurance Co.*, (1874) L.R. 19 Eq. 302.

It is easier to state when set-off is not available than when it is. The intricate interplay of legislation, common law rules and equitable principles amounts to little more than a statement that where one or both cross demands are for damages, and they are unrelated, set-off is unavailable.

Earlier, we raised a question to be considered later in this Report. Is it desirable to retain two procedures by which a defendant may set up a cross demand? Two further questions may be asked. First, would the law be better served by a legislative restatement of the principles of set-off? Legislation could state in simple and clear terms what is currently described in technical detail and obscure language. Second, is there any justification for the limitations, acknowledged by the current law, on cross demands that can be set-off? These questions should be kept in mind as the law of set-off is explored in greater detail in the following chapters.

CHAPTER III

SET-OFF BETWEEN ORIGINAL PARTIES

A. Introduction

It was mentioned earlier that two methods of raising a cross demand against a plaintiff are available to a defendant: set-off and counterclaim.

Set-off is based on the policy that when a plaintiff proceeds against a defendant, certain kinds of cross demands owed to the defendant should be heard in the same proceedings. Technical rules have been developed to determine what kinds of cross demands can be set-off.

Counterclaim permits a defendant to raise any cross demand against a plaintiff unless it is inconvenient to do so. One would expect that the introduction of rights of counterclaim would have removed the need for rights of set-off, but that has not happened. There are several reasons why rights of set-off have retained their importance.

One reason is that the manner in which set-off operates is fairly clear from a theoretical perspective. Set-off is regarded as a defence, which may be relied upon to diminish or extinguish the plaintiff's claim. It allows the courts, in some cases, to regard the obligations of the parties on a net basis.

With the introduction of rights of counterclaim, however, it was not clear what theory was being endorsed. Was the older "net basis" concept being abandoned in favour of administrative convenience? Or was it the policy to expand the "net basis" concept to sweep in damages and other unliquidated claims? Or were two separate methods of raising cross demands, based upon inconsistent theories, to co-exist in an uneasy and undefined relationship?

For several decades after counterclaim was introduced, it was unsettled whether it had subsumed rights of set-off.[1]

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[1] The law of set-off represents early attempts by the law to deal with procedural limitations. The inability to pursue cross demands in the same proceeding led to the development of principles which would permit the courts to take into account some kinds of cross demands. In 1873, those procedural limitations were removed. Since the introduction of the right to counterclaim, the law of set-off has been further modified so that, insofar as original parties are concerned, there are few distinguishing features between them. Distinctions between set-off and counterclaim nevertheless exist. One distinction arises when it comes to the determination of costs: *see infra*, n. 17. (con't.)

Most cases now acknowledge that counterclaim does not replace rights of set-off.[2] The courts have interpreted rights of counterclaim restrictively. There are, consequently, some things that set-off can do that counterclaim cannot.

Set-off has some significance when cross demands exist between the original parties, although for the most part, rights of counterclaim have largely removed the need for set-off. Set-off is most important when a third party acquires the right to proceed on a claim, and the defendant wishes to raise a cross demand owed by the person originally entitled to enforce the claim.

In this chapter, we examine those situations where rights of set-off are asserted between the original parties. The next chapter explores rights of set-off when a third party is involved.

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1. (con't.) There is a further procedural distinction between set-off and counterclaim which flows from the characterization of set-off as a defence to an action by a plaintiff: *see, e.g.*, *Stooke* v. *Taylor*, (1880) 5 Q.B.D. 569 (C.A.). When the plaintiff's claim is discontinued, the defendant may not proceed on a cross demand pleaded as a set-off unless further proceedings are commenced: *Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*, (1915) 8 W.W.R. 1124 (B.C.C.A.); *McGowan* v. *Middleton*, (1883) 11 Q.B.D. 464, 470 (C.A.). Where, however, a cross demand is pleaded as a counterclaim, the defendant may proceed on it even if the plaintiff discontinues his action. Rule 21(14) provides:

> 21(14) Where, in an action in which the defendant has set up a counterclaim, the action of the plaintiff is stayed, discontinued or dismissed, the counterclaim may proceed.

This limitation on set-off can be circumvented in one of two ways. A cross demand might be raised as both a set-off in the statement of defense and as a counterclaim. If the set-off is not properly pleaded, judgment may still be granted on the counterclaim. Or, the cross demand might be raised by counterclaim, provided it is clearly indicated to be a set-off: *see infra*, n. 17 and Chapter IV, n. 1.

[2] Many cases have considered the law of set-off as it applies between original parties when one or both cross demands is not for debt. The decisions on this point are inconsistent. In some cases, it is held that any cross demand may be set-off between the original parties: *Victoria Saanich Motor Transportation Co.*, *ibid.*; *Bankes* v. *Jarvis*, [1903] 1 K.B. 549, 553; *Zauscher* v. *Earl*, [1943] 2 W.W.R. 697 (B.C.C.A.); *Stucki* v. *Reed*, (1967) 61 D.L.R. (2d) 351, *rev'd* but not on this point, (1967) 62 D.L.R. (2d) 535 (B.C.C.A.). This position is based on Rule 19(13) of the *Rules of Court*, which seems to put all cross demands on the same footing. In other cases, it has been held that where one of the cross demands is not for debt, set-off is only available where there is an equity to intervene, the position adopted by the law before the introduction of Rule 19(13): *see Pos* v. *Pos*, (1985) 61 B.C.L.R. 388 (S.C.); *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14 (B.C.C.A.); *Mersey Steel and Iron Co.* v. *Naylor, Benzon & Co.*, (1882) 9 Q.B.D. 648 (C.A.); *In re Milan Tramways Co.*, (1882) 22 Ch. D. 122, (1884) 25 Ch. D. 587 (C.A.); *In re Leeds and Hanley Theatres of Varieties, Ltd.*, [1904] 2 Ch. 45; *Stooke* v. *Taylor*, *ibid.*; *Stumore* v. *Campbell & Co.*, [1892] 1 Q.B. 314 (C.A.); *Dominion Trust Company* v. *Brydges*, (1920) 28 B.C.R. 451 (S.C.); *Kaps Transport Ltd.* v. *McGregor Telephone & Power Construction Co.*, (1970) 13 D.L.R. (3d) 732 (Alta. S.C., App. Div.). Courts that adopt this view proceed on the basis that Rule 19(13) does not alter the former law. Most recent British Columbia decisions adopt this view.

B. When are Rights of Set-Off Relevant Between the Original Parties?

A survey of modern cases reveals that rights of set-off are asserted between original parties in several discrete situations. These situations are discussed in this section.

1. TO RAISE CLAIMS WHEN COUNTERCLAIM IS UNAVAILABLE

Set-off is relied upon when counterclaim is unavailable. Counterclaim is unavailable in only three situations:

(a) where the cross demand already forms the basis of a separate proceeding;

(b) where the court has ordered that the counterclaim be struck out on the basis that it is inconvenient or inappropriate to be heard in the proceeding commenced by the plaintiff; and

(c) where a limitation period has expired.

(a) Separate Proceedings

An example of the first situation is to be found in *Pos* v. *Pos*,[3] which involved a dispute between a husband and wife. Proceedings had been commenced in Ontario concerning rights to family property. In British Columbia, the wife brought an action to enforce an order for costs in her favour that had been made by an Ontario court. The husband argued unsuccessfully that his rights to family property should be set-off against the wife's entitlement to costs.

Comment

In a situation of this kind, a defendant need not rely on rights of set-off or counterclaim. If judgment is handed down against him, he may apply to have execution on the judgment stayed until the other proceeding is concluded.[4] There is no guarantee, of course, that such an application will be successful. Still, it is difficult to see why the law of set-off needs to be retained to deal with a problem of this nature, since the courts have available to them a means of ensuring that one party does not steal a march on another merely by receiving judgment on his claim first. The suggestion that an order restraining proceedings, or execution, obviates the need for rights of set-off in this context is touched with a certain irony. Initially, equity did not allow cross demands to be set-off in the modern sense of that word. It would restrain proceedings on one demand until proceedings could be brought on a cross demand.[5]

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[3] *Ibid.*

[4] Rule 42(25) provides:

> 42(25)(a) The court may, at or after the time of making an order,
> (i) stay the execution of the order until such time as it thinks fit, or
> (ii) provide that an order for the payment of money be payable by instalments.
>
> (b) Without limiting the generality of paragraph (a), a party against whom an order has been made may apply to the court for a stay of execution or other relief on grounds with respect to which the supporting facts arose too late for them to be pleaded, and the court may give such relief as it considers just. (con't.)

(b) Inappropriate To Hear At the Same Time

An example of the second situation is to be found in *Brattberg* v. *Royal Bank of Canada.*[6] The defendant's counterclaim was struck out on the basis that it was inappropriate to be heard at the same time as the plaintiff's claim. The defendant then applied to plead his claim as a set-off. It was held that rights of set-off were unavailable. Essentially, the defendant raised set-off in an attempt to avoid a judicial decision that it was inappropriate to hear the defendant's cross demand in the plaintiff's proceeding.

Comment

Set-off need not be retained in order to permit a party to place before the court the same issue twice. If it is inappropriate to hear a cross demand raised as a counterclaim in a proceeding commenced by the plaintiff it is unlikely to be appropriate to hear the same cross demand as a set-off in that proceeding.

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4. (con't.) *See also Court of Appeal Act*, S.B.C. 1982, c. 7, s. 18. In *Neiman* v. *Edward*, (1987) 17 C.P.C. (2d) 133 (Ont. Dist. C.), the defendant raised an unliquidated demand as a set-off or counterclaim to resist the plaintiff's application for summary judgment. It was held that, whether raised as a set-off or counterclaim, an unliquidated demand could not stand in the way of summary judgment. The plaintiff was granted judgment. An order staying enforcement of the judgment until the defendant's claim was resolved by judgment was then made. The British Columbia *Rules of Court* contemplate a similar procedure where default judgment is obtained. Rule 25(10) provides:

> 25(10) Unless the court otherwise orders, where there is a counterclaim the plaintiff shall not issue execution on a judgment obtained under this rule until the entire action has been disposed of.

See Minor Report on the Jurisdiction of Local Judges: Stays of Execution and Instalment Orders (LRC 72, 1984) (reprinted as an Appendix to LRC 73); *cf. Re Toronto Apartment Buildings Co. and Gambhir*, (1987) 39 D.L.R. (4th) 444 (Ont. H.C., Div. Ct.).

5. *See supra*, Chapter II, n. 7. From this procedure developed set-off as we understand it today. *See also infra*, Chapter VIII, n. 17.

6. (1987) 52 Alta. L.R. (2d) 173 (C.A.).

(c) Expired Limitation Period

Legislation provides that after a certain length of time has passed a person may not bring an action for a remedy.[7] Similarly, in some cases,[8] the parties may agree that an action may not be brought after a defined period of time.

If a limitation period prevents a person from bringing an action with respect to a particular matter, neither may he raise a counterclaim for it. He may, however, still be able to raise his cross demand as a set-off.[9]

Comment

The law defines limitation periods because it is important that persons be diligent in protecting their rights. Eventually, there must be an end to litigation. If a person delays too long, he will not be permitted to proceed.

There is little merit in retaining two procedures for raising cross demands in proceedings brought by the plaintiff merely in order to avoid the consequences of a limitation period.[10]

Moreover, the distinctions drawn by the law in this context reflect, in part, a technique for defining limitation periods which is no longer supported by modern policy. At one time it was common to provide that, after the expiration of a certain period of time, a person could not bring an *action* to claim a remedy with respect to a particular claim. The limitation period, however, did not affect the underlying obligation. Consequently, if the obligation could be raised without bringing a proceeding, as a set-off for example, the limitation period was of no effect. Modern policy, reflected in British Columbia's *Limitation Act*, has now turned from barring the remedy to extinguishing the right or obligation.[11] The use of set-off to avoid limitation periods is inconsistent with this policy.

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[7] *See, e.g., Limitation Act*, R.S.B.C. 1979, c. 236.

[8] *See, e.g., Aries Tanker Corp. v. Total Transport Ltd.*, [1977] 1 W.L.R. 185, [1977] 1 All E.R. 398 (H.L.); *Federal Commerce and Navigation Ltd. v. Molena Alpha Inc.*, [1978] 1 Q.B. 927, [1978] 3 All E.R. 1066 (C.A.).

[9] *Federal Commerce and Navigation Ltd., ibid.*

[10] The distinctions in theory which support these two procedures for raising cross demands mask the fact that they are intended to serve the same purpose. *See*, further, *infra*, Chapter VI, n. 3.

[11] *See infra*, Chapter VI, n. 3.

2. TO ATTEMPT TO LIMIT RIGHTS OF COUNTERCLAIM

In some cases, the plaintiff has attempted to defeat a counterclaim by arguing that the defendant could not have raised his cross demand by set-off. One example is useful to demonstrate how set-off is being used in this context.[12]

When a landlord has a claim for rent against a tenant, in some cases he may seize the tenant's goods, sell them and apply the proceeds to the arrears of rent. If the landlord does so wrongfully, the tenant has a claim for damages against him. If the tenant sues the landlord, it appears that the landlord is not permitted to set-off the rent he is owed.[13]

For the purposes of our present discussion, it is enough to observe that, although the landlord cannot set-off his claim for rent, he can bring a separate action against the tenant to recover it.[14]

Counterclaim is the means by which separate actions between the parties are heard at the same time. The fact that set-off is unavailable to a landlord, consequently, cannot affect his right to counterclaim. Yet, in several modern cases, the courts have had to face this argument.[15] Usually this argument to restrict rights of counterclaim fails.[16]

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[12] *See also* cases concerning

(a) negotiable instruments: commerce requires a medium of exchange. For that reason, negotiable instruments are not subject to principles of set-off except to a limited extent between the original parties. Restrictions on rights to counterclaim seem largely to have been recognized in reliance on principles of set-off. *See* Crawford & Falconbridge, *Banking and Bills of Exchange*, (8th ed., 1986) vol. 2, Chapter 50; B. Geva, *Financing Consumer Sales and Product Defenses* (1984) Chapter 5; *Iraco Ltd.* v. *Staiman Steel Ltd.*, (1986) 54 O.R. (2d) 488 (H.C.) *aff'd*, (1987) 62 O.R. (2d) 129 (C.A.)

(b) freight: A claim for payment under a voyage charter (known as "freight") is not subject to rights of set-off arising, for example, from deficiencies in the services performed: *Aries Tanker Corp.*, *supra*, n. 8; *A/S Gunnstein & Co. K/S* v. *Jensen, Krebs & Nielsen (The "Alfa Nord")*, [1977] 2 Ll.L.R. 434 (C.A.); *James & Co. Scheepvaart en Handelmij B.V.* v. *Chinecrest Ltd.*, [1979] 1 Ll.L.R. 126 (C.A.); *S/S Steamship Co.* v. *Eastern Carribean Container Lines S.A.*, [1986] 2 F.C. 27, 26 D.L.R. (4th) 472 (F.C.A.). In *Federal Commerce and Navigation Ltd.*, *supra*, n. 8, however, a distinction was drawn between a claim for freight for the carriage of cargo, and hire for the use of a vessel under a time charter party. Set-off is available in the latter instance; *see also Santiren Shipping Ltd.* v. *Unimarine S.A.*, [1981] 1 All E.R. 340 (Q.B.); *Colonial Bank* v. *European Grain Shipping Ltd.*, [1988] 3 W.L.R. 60 (C.A.).

(c) subrogation: in *Lewenza* v. *Ruszczak*, [1960] O.W.N. 40 (C.A.) it was held that a cross demand could not be raised against an insurer subrogated to the claim of the insured. This position was finally rejected, however, in *Best Buy Carpets Ltd.* v. *281856 B.C. Ltd.*, [1987] B.C.D. Civ. 1941-01 (S.C.).

[13] *Attack* v. *Bramwell*, (1863) 3 B. & S. 520, 122 E.R. 196.

[14] *Ibid.*

[15] *Central Equities Ltd.* v. *Central Interior Hardware Ltd.*, [1986] B.C.D. Civ. 2324-02 (S.C.); *Country Kitchen Ltd.* v. *Wabush Enterprises Ltd.*, (1980) 99 A.P.R. 391, 400, 35 Nfld. & P.E.I.R. 391, 400 (Nfld. C.A.); *Beaver Steel Inc.* v. *Skylark Venutres Ltd.*, (1983) 47 B.C.L.R. 99 (S.C.).

[16] *See, e.g.*, *B & M Enterprises Ltd.* v. *Crosbie Enterprises Ltd.*, (1982) 111 A.P.R. 153, 160, 39 Nfld. & P.E.I.R. 153, 160 (Nfld. S.C., T.D.), where it was said: (con't.)

Comment

In cases like these, retaining two procedures for raising a cross demand has only created confusion in the law. Rights of set-off in this context are not being used to bridge gaps in rights of counterclaim. They are being relied upon in an attempt to defeat modern policies.

3. To Determine An Award Of Costs

An issue that arises from time to time concerns the appropriate method of awarding costs when the defendant could have raised his cross demand either as a set-off or counterclaim.[17] As a general rule, when a counterclaim is involved, each party's proceeding is regarded as a separate matter, and separate awards of costs are made for each proceeding.

Set-off depends upon a different theory. A cross demand raised by set-off is not considered to be a separate proceeding. Consequently, only one order of costs will be made.[18]

Comment

When a proceeding involves a cross demand, costs are awarded by reference to the manner in which the cross de-

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16. (con't.)

> It cannot be the judgment of the court that a tenant should receive damages equal to the value of the goods illegally distrained upon and at the same time be excused from the payment of rent. Apart from that, the law of set-off applies between mutual debtors. I cannot extinguish that law. It seems to me improper that a landlord should not be entitled to offset his rent against damages awarded against him for illegal distress.

[17] Where a successful set-off extinguishes the plaintiff's claim, the plaintiff will have costs awarded against him. The defendant will have judgment for the balance, if any, plus costs: *see Derco Industries Ltd.* v. *A.R. Grimwood Ltd.*, (1986) 20 C.L.R. 174 (S.C.B.C.). A similar rule also seems to apply to an award of court order interest: *Goetz* v. *Sherkat*, (1986) 39 A.C.W.S. (2d) 124 (B.C. Co. Ct.). *See also* Williston and Rolls, *The Law of Civil Procedure* (1970) vol. 2, 719. Where the claim is successfully advanced as a counterclaim, the court gives two judgments, one for the plaintiff and one for the defendant, and awards costs appropriately to each party on the basis of the success of his claim: *Victoria Saanich Motor Transportation Co., supra*, n. 1; *Hughes* v. *O'Sullivan*, (1986) 12 C.P.C. (2d) 62 (B.C.C.A.). In *Hanak* v. *Green*, [1958] 2 Q.B. 9 (C.A.), the defendant succeeded on a counterclaim. The court, however, held that since the claim could have been advanced as a set-off, costs should be awarded to the defendant on that basis, rather than on the basis of a successful claim and counterclaim. It should be noted that the case involved a review of an arbitrator's decision so that it may not be entirely correct to characterize it as a case in which a counterclaim was pleaded. Nevertheless the position seems to be that in England the discretion of courts to award costs is not fettered by whether a cross-demand is pleaded as a set-off or counterclaim. The law of Ontario is similar: *Gates* v. *Seagram*, (1909) 19 O.L.R. 216 (C.A.); *Cutler* v. *Morse*, (1888) 12 P.R. 594. Moreover, courts in England are encouraged to make a special order respecting the awarding of costs on the basis of a single proceeding: *Chell Engineering Ltd.* v. *Unit Tool and Engineering Co.*, [1950] 1 All E.R. 378 (C.A.); *Childs* v. *Gibson*, [1954] 1 W.L.R. 809 (C.A.); *see also* D.B. Casson & I.H. Dennis, *Odgers' Principles of Pleading & Practice* (22nd ed., 1981) 209. In British Columbia, it has been held that an election to plead a counterclaim rather than a set-off binds the defendant for the purpose of awarding costs: *Victoria Saanich Motor Transportation Co., supra*, n. 1.

[18] *Ibid.*

mand is raised. It is difficult to see how the defendant's choice of procedure actually affects the costs of the parties to the proceedings.

An alternative to the current law would be to award costs solely by reference to the success of the defendant's cross demand. Arguably, when a defendant's cross demand extinguishes a plaintiff's demand the plaintiff was not justified in bringing the proceeding. Only one order of costs would be made, in favour of the defendant. If the defendant's cross demand only diminished the plaintiff's principal demand, then two orders of costs would be made. In that case, the plaintiff would be justified in bringing the proceedings.

An approach along these lines incorporates principles analogous to those that apply when a defendant makes a payment into court. A plaintiff who refuses to accept a payment into court which is vindicated by the judgment at trial is subject to a costs sanction. Rule 37(17) applies when a payment into court is refused:[19]

> Where the plaintiff proceeds with an action and recovers an amount equal to or less than the amount paid into court,
> (a) he may tax his costs reasonably incurred up to delivery to him of a copy of the notice under subrule (7) and, provided the notice was delivered at least 7 days prior to the commencement of the trial, the defendant may tax his costs reasonably incurred after delivery of the notice to the plaintiff; but if the notice was delivered less than 7 days prior to the commencement of the trial, the costs of any steps taken by the parties subsequent to delivery shall be in the discretion of the court, and
> (b) the amount paid in shall be applied in satisfaction of the plaintiff's judgment after set-off of the defendant's costs, if any, and any balance shall be repaid to the defendant.

Costs are used to penalize a person who brings litigation needlessly.

It would be possible to adopt a rule for awarding costs which is based on the success of the defendant in raising a cross demand, but this would appear to be unnecessary. The *Rules* already provide that a formal offer by a defendant to surrender a counterclaim is treated like a payment into court:

> 37(22) Where a counterclaim is asserted, a defendant may offer to surrender his counterclaim, or may pay into court a sum of money and offer to surrender his counterclaim, in

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[19] *See also Report on Settlement Offers* (LRC 77, 1984).

> satisfaction of one or more of the plaintiff's claims in settlement of the action and counterclaim.
>
> 37(24) Subrules (1) to (21) apply *mutatis mutandis* to the offer to surrender a counterclaim as though it were payment of money into court.

If the plaintiff refuses the offer to surrender a counterclaim, and judgment is less than or equal to the value of the counterclaim, he will be penalized in costs.

4. TO DETERMINE WHETHER THERE HAS BEEN A BREACH

A plaintiff may allege that a defendant is in breach of an obligation. For example, a contract between the parties may require the defendant to make a payment. When a defendant successfully raises a set-off which extinguishes the plaintiff's claim, it might seem that a court has one of two options open to it. It might hold that the defendant is in breach of the contract, although he need not pay the plaintiff anything. Or, it might hold that the existence of the set-off means that the defendant is not in breach at all.

This is a matter of some significance. If the defendant is in breach of the contract, the plaintiff might have certain rights it can assert under the contract. Or, the plaintiff might be able to accept the defendant's breach as a repudiation of the contract, and bring it to an end.

It appears to be settled that where a set-off extinguishes the plaintiff's claim, the defendant is not in breach at all. This seems to follow from characterizing the operation of set-off as a defence. We will have more to say on this point after we turn to some examples of this aspect of set-off.

(a) Specific Performance

In *B.I.C.C.* v. *Burndy*,[20] the plaintiff was entitled to require that the defendant assign patent rights to it if the defendant failed to reimburse it for certain sums within 30 days of a written request to do so. The defendant failed to reimburse the plaintiff as required, but was owed a sum in excess of that which it owed the plaintiff. It was held that the defendant was entitled to a set-off, which extinguished the plaintiff's claim. Because the defendant was not in breach of the agreement, the plaintiff could not compel an assignment of the patent rights.

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[20] [1985] 1 All E.R. 417 (C.A.).

(b) Deductions and Breach of Contract

Sometimes, in the course of dealings between two people under a contract or business arrangement, one deducts money he is owed from payments he makes to the other.[21] The concern is whether the deduction may be made or whether making it is a breach of the agreement between the parties. Generally, when one party is in breach of an agreement, the innocent party may do one of two things. He may affirm the contract, and sue for damages resulting from the breach. Or he may accept the breach as a repudiation of the agreement, bringing it to an end, and sue for damages.[22]

Clearly, it is a matter of some importance whether a party may make deductions from payments he owes under a contract without being in breach of his obligations. It would appear that there are only two situations where a deduction may be made that will not cause a breach: when the contract permits deductions to be made and when the deduction is for an obligation which may be set-off.[23]

Comment

Determining whether a party is in breach of his obligations under an agreement appears to be a situation where rights of set-off between original parties still performs a useful function. The use of set-off for this purpose, however, is not altogether satisfactory. It seems to be a modern phenomenon, predicated on the view that since set-off is characterized as a defence, it must operate as a defence for all purposes.

In fact, however, set-off has never, until recently, been considered a substantive defence in the sense that proof of a set-off which extinguishes a plaintiff's claim means that the defendant is not in breach at all. In the late nineteenth century, set-off was regarded as a defence solely for procedural purposes. That characterization described the way a set-off was brought, but did not otherwise control how it functioned. For example, it has been said that set-off:[24]

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[21] *Aries Tanker Corp., supra*, Chapter II, n. 7; *Federal Commerce and Navigation Ltd., supra*, Chapter I, n. 7.

[22] *Ibid.*

[23] *Ibid.*; *see also Sim* v. *Rotherham Metropolitan Borough Council*, [1986] 3 All E.R. 387 (Ch. D.).

> ...does not dispute the existence and validity of the plaintiff's claim, for it cannot be enforced and given effect to except upon an admission of the plaintiff's claim.

There is some doubt, consequently, how appropriate it is to determine other rights between the parties based solely on whether the defendant's set-off extinguishes the plaintiff's claim. In terms of principle, it would appear that this issue should be resolved by reference to the degree of interrelationship between the cross demands. Since that principle underlies the current law of set-off, probably little harm is done by approaching the issue purely from an arithmetic stance based on the operation of the law of set-off. Nevertheless, it would be more desirable for the courts to peer past the law of set-off and identify the principles which should apply to determine in what circumstances cross obligations can be said to nullify each other. The distinction to be drawn is between rights and remedies. The law of set-off, traditionally, has functioned upon the basis that a plaintiff has rights (or is owed obligations) but the remedy he is entitled to must be determined by reference to obligations he owes the defendant. It is quite a different matter to say that obligations a plaintiff owes affect the rights he has, as opposed to the remedies he is entitled to.

C. Conclusion

1. ONE PROCEDURE FOR RAISING CROSS DEMANDS

With one exception, the purposes for which set-off is relied upon between original parties strike us as being neither useful nor desirable. The one area where set-off appears to retain any utility is the function it performs in determining whether a defendant is in breach of obligations he owes a plaintiff. We will return to this issue shortly.

The discussion in this chapter underscores the problems that arise from retaining two distinct methods of permitting a defendant to raise a cross demand. It is our conclusion that the law should be amended, to provide for a single procedure for raising a cross demand. In our view, rights of set-off should be subsumed by rights of counterclaim.

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[24] W.H. Trueman, "Set-off and Counterclaim," (1899) 35 C.L.J. 10.

In the Working Paper that preceded this Report, an approach based on retaining both procedures was suggested. It was tentatively proposed that legislation should be enacted to equate rights of set-off and counterclaim between the original parties. Under such legislation, a defendant would be able to raise any demand against the plaintiff, either as a set-off or a counterclaim. One apparent advantage of that scheme is that it would avoid creating procedural pitfalls for the unwary, something which might occur if legislation prevented a defendant from raising rights of set-off.[25] Moreover, set-off is a useful word to describe the method of dealing with competing demands. The chief problem is how to remove the historical baggage that has attached itself to rights of set-off and rendered the law exceedingly complex.

It is possible, however, to replace rights of set-off with rights of counterclaim without creating procedural hazards. Legislation need only provide that a cross demand raised as a set-off is deemed to be a counterclaim. In our view, this approach should be adopted. There is no need to retain two procedures by which a defendant may raise a cross demand against a plaintiff.

2. SET-OFF OUTSIDE LITIGATION

The only situation in which set-off between original parties retains any utility is to determine whether one party is in breach of his obligations under an agreement. It is an issue which initially arises outside the process of litigation. Although it has been considered in only a handful of cases, it is, nevertheless, an important issue.

Two options are available in order to ensure that the law continues to define whether a breach occurs when a party, while owed an obligation, makes a deduction from a payment or fails to perform an obligation he owes in turn. Legislation could define when rights of counterclaim are available to operate as a defence. Alternatively, the law of set-off between original parties could be retained for the limited purpose of determining when there has been a breach.

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[25] Questions of this nature arose when the procedure and jurisdiction of the courts were fundamentally recast by the Judicature Acts. At that time an ultimately unsuccessful attempt was made to merge the procedures of set-off and counterclaim: *see infra*, Chapter IV, n. 1.

Since problems of this nature rarely arise, it is our conclusion that the second of these options should be adopted. Legislation revising rights of counterclaim and of set-off should provide that it does not affect rights of set-off between original parties for the purpose of determining whether there has been a breach of an obligation and, if so, whether additional rights or obligations arise as a result of it.

CHAPTER IV

SET-OFF AGAINST A SUCCESSOR IN INTEREST

A. Introduction

When a defendant is owed an obligation by the plaintiff, he may raise it in the proceeding brought by the plaintiff.

Suppose, however, the plaintiff (P) acquired the right to bring his action from another person (A) and the defendant has a claim against A. The defendant cannot proceed by counterclaim against P on a cross demand owed by A.[1]

Consequently, there are limits on the utility of a counterclaim when a third party becomes entitled to enforce an obligation by assignment or by reason of insolvency. In these cases, however, the ancient law of set-off sometimes provides a remedy.

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[1] More strictly, the defendant may raise a *set-off* by counterclaim against an assignee. He may not, however, raise any of the broader range of cross demands that can usually be brought by counterclaim. *See Government of Newfoundland* v. *Newfoundland Ry. Co.*, (1888) 13 App. Cas. 199 (P.C.). In *Hanak* v. *Green*, [1958] 2 Q.B. 9 (C.A.) it was said:

> For the reasons that I have indicated, I consider that a cross-claim [brought by counterclaim] can be regarded as a set-off if in a court of law it would have been so regarded by a court of equity as the basis for equitable set-off or for giving protection on equitable grounds to a defendant.

In *Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*, (1915) 8 W.W.R. 1124 (B.C.C.A.) it was held that where a cross demand was brought as a counterclaim without distinctly pleading set-off, costs will be awarded on the basis of counterclaim. *See supra*, Chapter III, n. 17; *see also Jacome* v. *McDonald*, (1986) 19 C.P.C. (2d) 93 (Ont. S.C.). *See further infra*, Chapter VI A.1(d) "Amendments to the *Rules of Court*." Modern courts view set-off and counterclaim as distinct, and are sometimes in doubt concerning the status of a set-off which is raised as a counterclaim instead of as a defence. The changes wrought by the Judicature Acts, however, were not originally regarded by the courts in this manner. The interpretation then was that any set-off had to be brought by counterclaim, and the issue was whether it was sufficient to plead a set-off as a defence. In *Lees* v. *Patterson*, (1876) 7 Ch. D. 866 the plaintiff brought a writ for an accounting regarding a partnership and obtained a writ *ne exeat regno* under which the defendant was arrested. The writ was improperly obtained. In his statement of defence the defendant raised the unliquidated damages arising from the improper arrest as a set-off. Counsel for the plaintiff argued that "the claim for damages and the set-off are not properly raised by way of counter-claim; there is no allegation of the facts relied upon distinct from the defence, and no prayer or claim as there should be in a counter-claim." Fry, J. (at 868), said:

> ...in *Crowe* v. *Barnicot* the Defendant only claimed damages "for the loss he has sustained in consequence of his expenditure aforesaid." Here the reference is to "the said two orders and writ of *ne exeat regno*," which have been previously mentioned. I think this is unobjectionable. It is not necessary that a counter-claim should have the words "by way of counter claim" printed in big letters at the head of it. I think this case does not come within my ruling in *Crowe* v. *Barnicot*.

Fry J refused to allow the technicalities of pleading to prevent a cross demand from being raised. That was no doubt a salutary approach, consistent with the reforms introduced by the Judicature Acts. Nevertheless, to this decision can probably be credited the survival of set-off as a form of pleading distinct from counterclaim, since it was not necessary to raise a set-off by counterclaim. It is interesting to note that the court was not concerned with whether the unliquidated claim qualified as a set-off under the former law, an enterprise which occupies modern courts.

B. Assignments

A third party will become entitled to enforce a claim originally owed to another in several circumstances. These are all cases of assignment. Assignments may be divided functionally into three general categories: assignments for value, as security, and for the benefit of creditors.

1. ASSIGNMENT FOR VALUE

A person who is owed an obligation may assign it to another person, called the assignee. In an assignment for value, the assignee purchases the right to enforce the assigned obligation.[2]

2. ASSIGNMENT AS SECURITY

An assignment as security performs a function that differs from that performed by an assignment for value. A lender may advance funds to a borrower. Concerned that the money be repaid, the lender may require security, such as a mortgage against real property. Usually, a lender will not look to the security unless the borrower defaults.

A borrower who is owed money by others will often assign his claims to the lender as security. Again the lender, as in the case of a mortgage, will usually only look to this kind of security if the borrower defaults.

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[2] Technical rules govern the making and enforcement of an assignment. The general rule is that an assignment is subject to the equities that existed between the original parties before notice of the assignment was given: *Canadian Encyclopedic Digest (Western)* (3rd ed.) vol. 5, 25-61, para. 190. Any defence that could have been raised against the assignor can also be raised against the assignee: *ibid.*; Keeton and Sheridan, *Equity*, (2nd ed., 1976) 209; *see also Stoddart* v. *Union Trust, Ltd.*, [1912] 1 K.B. 181 (C.A.); *In re Knapman*, (1881) 18 Ch. D. 300 (C.A.); *In re Jones*, [1897] 2 Ch. 190. An exception is made if the claim arises from the assigned contract or a related transaction: *Canadian Encyclopedic Digest (Western)* (3rd ed.) vol. 5, 25-65, para. 209; *see also Biggerstaff* v. *Rowatt's Wharf, Ltd.*, [1896] 2 Ch. 93 (C.A.); *Parsons* v. *Sovereign Bank of Canada*, [1913] A.C. 160 (P.C.); *Graham* v. *Johnson*, (1869) L.R. 8 Eq. 36; *William Pickersgill & Sons, Ltd.* v. *London & Provincial Marine & General Insurance Co.*, [1912] 3 K.B. 614; B. Geva, *Financing Consumer Sales and Product Defenses*, (1984) Ch. 3 at 52. Occasionally, a person under an obligation to another will acquire a cross demand for the purposes of set-off. For example, A owes B $1000. C owes D $1000. Suppose A takes an assignment of C's debt from D and C takes an assignment of A's debt from B. Where the cross-demand is acquired after receipt of notice of assignment of the primary obligation, it may not be set-off: *see, e.g., Bennett* v. *White*, [1910] 2 K.B. 1 *rev'd*, [1910] 2 K.B. 643 (C.A.); *N.W. Robbie & Co.* v. *Whitney Warehouse Co.*, [1963] 3 All E.R. 613 (C.A.); *United Steel Corp. Ltd.* v. *Turnbull Elevator of Canada Ltd.*, [1973] 2 O.R. 540 (C.A.); *Lynch* v. *Ardmore Studios (Ireland) Ltd.*, [1966] I.R. 133 (S.C.); *Northern Electric Co.* v. *Auto Service Co.*, (1961) 2 C.B.R. 218 (Nfld. S.C.); *Royal Bank of Canada* v. *Wallace Investments Ltd.*, (1961) 3 C.B.R. 34 (B.C. Co. Ct.); *Felt and Textiles of New Zealand Ltd.* v. *R. Hubrich Ltd. in Receivership*, [1968] N.Z.L.R. 716 (S.C.); *Simpson Shatula Redi-Mix & Building Ltd.* v. *Keir Tire Ltd.*, (1982) 45 C.B.R. 26 (Sask. Q.B.); *Fair* v. *M'Iver*, (1812) 16 East. 130, 104 E.R. 1038; *Lackington* v. *Combes*, (1839) 6 Bing. (N.C.) 71, 133 E.R. 28; *In re Gillespie*, (1885) 14 Q.B.D. 963; *Forster* v. *Wilson*, (1843) 12 M. & W. 191, 152 E.R. 1165; *Jenna Construction Ltd.* v. *Croft*, (1987) 4 A.C.W.S. (3d) 227 (B.C. Co. Ct.). This position is consistent with the general rules concerning assignments. Moreover, in terms of policy, on a receivership or bankruptcy, consolidating claims in this way is likely to prejudice secured creditors. Where the cross-demand is acquired before notice of the assignment is received, however, it may be set-off: *Thibaudeau* v. *Garland*, (1896) 27 O.R. 391 (Div. Ct.).

A common kind of security today is the floating charge. A floating charge does not affect the debtor's right to deal with his property until it crystallizes. At that time, it becomes a fixed charge. The most common way of converting a floating charge into a fixed security is to appoint a receiver. The appointment of a receiver by a lender operates as an assignment of the claims the borrower is owed.[3] The assignment, consequently, resembles an assignment for value. Since in almost all cases the borrower is insolvent, however, the position of the person liable under the claim is functionally indistinguishable from bankruptcy (an assignment for the benefit of creditors).

3. ASSIGNMENT FOR THE BENEFIT OF CREDITORS

The law provides a mechanism for the collection of debts owed to a person who becomes insolvent and for the distribution of his assets among his creditors. In order to do this, the insolvent's property vests in a third party who represents him and his creditors. The most familiar example of this kind of assignment is bankruptcy. Receivership also resembles an assignment for the benefit of creditors, since a person who is owed money by the company in receivership for which he is unsecured faces the same peril as a general creditor of a bankrupt. Neither creditor's claim is likely to be satisfied.

When an insolvent person is petitioned into bankruptcy and a receiving order is made, the insolvent's property vests in a trustee in bankruptcy.[4] At that time the trustee in bankruptcy becomes entitled to enforce obligations originally owed to the insolvent person.

A person against whom a claim is asserted by the representative of an insolvent faces a particular problem. Unless he is entitled to a set-off, he must pay whatever he owed the insolvent. Any claim he was owed by the insolvent, however, is subject to the priorities that govern the distribution of the insolvent's property. The defendant will pay the representative 100 cents on the dollar. The insolvent, however, is unlikely to have enough assets to satisfy all the claims against him. The defendant, consequently, may receive on his claim something like 10 cents on the dollar. It must be emphasized, however, that this result follows only when a defendant is not permitted to set-off his cross demand.[5]

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[3] Insofar as the claims are covered by the floating charge. In *Biggerstaff* v. *Rowatt's Wharf, Ltd.*, *ibid.*, it was argued by the debenture holder that the assignment was complete when the debenture was issued. The court held that the assignment was complete upon the appointment of the receiver. A receiver is appointed either by court order or pursuant to a security instrument.

[4] *Bankruptcy Act*, R.S.C. 1970, c. B-3, s. 50(5); *In re Bright's Settlement*, (1880) 13 Ch. D. 413 (C.A.); *In re Daintrey*, [1900] 1 Q.B. 546 (C.A.); *In re Wallis*, [1902] 1 K.B. 719.

> A owes B $10,000. B injures A in an automobile accident, and A's damages, while not yet assessed, are approximately $15,000. B becomes bankrupt. The trustee in bankruptcy for B obtains a judgment against A for the $10,000. A must pay the trustee $10,000. He may also prove his claim for $15,000 in the bankruptcy. If he is not permitted a set-off, he will have to share with other creditors. A might receive $1500 of his claim.

In the example, if the net position is examined, B really owes A $5000 (the amount by which A's claim exceeds B's). It seems unfair, consequently, that A must pay anything to B's trustee in bankruptcy. In the example, A ends up paying $8,500 ($10,000 less the amount he receives on his claim).

A different result ensues when the defendant is permitted to raise his cross demand by set-off as a defence.

C. Terminology

It is useful at this point to add to the vocabulary we have been developing, by adopting terms to identify the parties in disputes that concern questions of set-off. We will call the third party who has become entitled to enforce a principal demand the "successor in interest." The person liable under the principal demand will be referred to as the "obligor." The person who was originally entitled to enforce the demand, and against whom the "obligor" has a cross demand, will be called the "assignor."

When a successor in interest sues the obligor, the obligor may not bring a counterclaim for an obligation he is owed by the assignor, although in some cases he can raise a cross demand as a set-off.[6]

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[5] As to whether A may set-off his claim, *see supra*, Chapter II, n. 16.

D. Set-Off Against A Successor in Interest

1. DEBTS AND OTHER CROSS DEMANDS

The general rule is that equitable set-off is available only when there is an equity to intervene. An exception seems to be made when the obligor seeks to set-off a debt against a debt. In that case, there is no need to establish an equity to intervene. Set-off is available by analogy to the Statutes of Set-Off.[7]

It should be kept in mind that the basis of equitable set-off is that in some cases justice requires that a cross demand be taken into account at the same time as the principal demand. A plaintiff's claim must be calculated with respect to the net position between the parties, by deducting from it claims the defendant has against the plaintiff.[8] Legislation provided that this was the case with debts. In all other cases, it was a question of fact whether the rights between the parties should be assessed by balancing the plaintiff's demand against the defendant's cross demand.

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[6] *Supra*, nn. 1 and 2. Before 1873, assignments were recognized only in equity: *see Row* v. *Dawson*, (1749) 1 Ves. Sen. 331, 27 E.R. 1064; G.H. Treitel, *The Law of Contract*, (7th ed., 1987) Ch. 16.; *Cottage Club Estates, Ltd.* v. *Woodside Estates Co. (Amersham)*, [1928] 2 K.B. 463, 467; *Jones* v. *Farrell*, (1857) 1 De G. & J. 208, 44 E.R. 703; *Royal Bank of Canada* v. *Gustafson*, (1924) 33 B.C.R. 379 (S.C.); *Canadian Admiral Corp.* v. *L.F. Dommerich & Co. Inc.*, [1964] S.C.R. 238; *Dennison* v. *Knox*, (1864) 24 U.C.Q.B. 119; *Whitehouse* v. *Roots*, (1860) 20 U.C.Q.B. 65; J. Kehoe, *The Law of Choses in Action*, (1881) 60. The manner in which an assignment was enforced depended upon the nature of the demand assigned. If the demand was one that could be enforced in a court of equity (an equitable chose in action) the assignee was permitted to sue in his own right: *Cator* v. *Croydon Canal Co.*, (1841) 4 Y. & C. Ex. 405, 593, 160 E.R. 1064, 1149; *Donaldson* v. *Donaldson*, (1854) Kay 711, 69 E.R. 303. If the assignment of an equitable chose in action was non-absolute, *e.g.*, if it was a charge or conditional on some event, the proceedings could only be brought by, or in the name of, the assignor: *In re Steel Wing Co.*, [1921] 1 Ch. 349; *Durham Brothers* v. *Robertson*, [1898] 1 Q.B. 765 (C.A.); *see* Cheshire & Fifoot & Furmston's *Law of Contract* (11th ed., 1986) 496. If the demand was one that could only be enforced in a court of law (a legal chose in action), equity would compel the assignor to bring the action on behalf of the assignee: *see* Treitel, *supra*, 500. In 1873, legislation was introduced that provided that an assignment which observed certain formalities was enforceable by the assignee: *Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 32, derived from s. 25(6) of the *Judicature Act, 1873*. An assignment which does not qualify as a statutory assignment is subject to the old rules for their enforcement: *William Brandt's Sons & Co.* v. *Dunlop Rubber Co.*, [1905] A.C. 454 (H.L.); *In re Hart Brothers Construction Ltd.*, (1954) 34 C.B.R. 116 (B.C.S.C.). An action on an assignment of a legal chose in action which does not satisfy the statutory requirements must be brought in the name of the assignor and the action would, consequently, be subject to any counterclaim maintainable against the assignor. This should be a point of some significance in the context of receiverships, but it is entirely overlooked.

[7] *Supra*, Chapter II, n. 7.

[8] At common law, if a defendant raised as a set-off a claim in excess of the amount of the claim against him, the court could not give judgment for the balance in his favour: *Stooke* v. *Taylor*, (1880) 5 Q.B.D. 569 (C.A.). This has been altered in British Columbia. Rule 21(15) provides:

> 21(15) Where a set-off or counterclaim establishes a defence to the plaintiff's claim, the court may give judgment for the defendant for any balance in his favour or for such other relief as the court thinks just.

2. The Problem

With the introduction of rights of counterclaim, almost all claims that may be asserted between the original parties are resolved on a net basis. If A owes B money, in court proceedings the amount owed will be calculated by deducting obligations B owes A.

When a successor in interest is involved, the law does not apply principles of counterclaim but of set-off to determine whether or not an obligation owed to the plaintiff should be calculated by deducting obligations the assignor owed to the defendant.[9] This approach limits the cross demands that may be raised by the defendant, thereby protecting the successor in interest.

Why does the law adopt two different methods for determining which cross demands may be raised by a defendant to diminish or extinguish a principal demand?[10] Why should different principles apply depending on whether the cross demand is raised against the party originally entitled to bring the principal demand or against a successor in interest?

It is difficult to say how much of the current law is based upon policy, reflects a pragmatic response to particular problems or is simply attributable to error. The cases, for the most

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9. This point seems to have first been recognized in the *Annual Practice* (1901) 292. Previous editions of the *Annual Practice* did not attempt to identify a reason for the survival of rights of set-off.

10. An answer, which seems to suggest that much of the current law is based upon a misconception, lies in the theoretical distinctions that are drawn between set-off and counterclaim. Set-off is characterized as a defence, and this quality is often cited as the chief distinction between set-off and counterclaim. It is difficult to see what advantage flows from this characterization. Matters which may be set-off are a class of cross-actions which, before 1873, could be raised in equity by a defendant in proceedings commenced by the plaintiff. They differ in no material respect from cross-actions which may be raised by counterclaim. In the sense that a set-off operates to resist, diminish or extinguish a plaintiff's claim, a set-off is a defence. Matters which may be only raised by counterclaim, however, also have that capacity. It is a distinction, consequently, without substance. It originated in the *Common Law Procedure Act, 1854*, s. 83 and was repeated in s. 24(5) of the *Judicature Act, 1873*, which provided that any matter which formerly would have supported an injunction could be relied upon by way of defence. *See* now *Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 8. Arguably, the *Judicature Act, 1873* was intended to replace rights of set-off with rights of counterclaim. Rights of counterclaim are characterized as cross-actions. It is difficult to see what is gained by classifying some cross-actions as defences, based on the fact that they were recognized in equity prior to the *Judicature Act, 1873* and classifying other cross-actions as separate matters which may, procedurally, be heard at the same time as the plaintiff's action. Strictly speaking, the law of set-off is procedural, and claims which may be set-off are distinct from matters which may be raised as substantive defences: *see* R.M. Goode, *Legal Problems of Credit and Security*, (1982) Chapter V.

part, do not disclose any theoretical perspective on the law, nor the reason for the result chosen. This is unremarkable when it is remembered that much of the law for much of its history has developed without regard for theory. Still, it may be asked, what principles support the current law? Why may some kinds of cross demands be set-off and others not? The cases do not provide an answer. The judges say that to not allow a set-off would be unfair, or to allow it would be unfair, and that is the end of it.

In *Aries Tanker*, for example, the House of Lords applied a particular rule regarding set-off. During the course of the decision, Lord Wilberforce said:[11]

> It is said to be an arbitrary rule--and so it may be, in the sense that no very clear justification for it has ever been stated and perhaps also in the sense that the law might just, or almost, as well have settled for a rule to the opposite effect. But this does not affect its status in the law....As to the argument from inconsistency with the rule prevailing in relation to the sale of goods, it is no part of the functions of this House, or the judges, to alter a well established rule or, to put it more correctly, to say that a different rule is part of our law, for the sake or harmonisation with a rule operating in a different field--not unless there is an intrinsic case, I would say a strong case, for altering the former rule.... To do this would be macro-architecture of the law and would be for a particular type of reformer.

It is open to the courts to adopt this position, but it is a conservative approach designed to achieve certainty, perhaps at the cost of fairness. For the most part, history reveals that the law is continually subject to reconsideration and refinement in the light of modern needs and policies, so that it evolves. It was not, for example, until the latter part of the nineteenth century that there was a general theory of contract "...which ignored all distinctions between the different kinds of contracts, and the different sorts of people that entered into them."[12] Before that, distinctions were drawn between commercial contracts and consumer contracts, and contracts of loan, employment, tenancies, marriage, partnership and so on. Many of the principles of set-off were developed piecemeal in the same way.

After the *Judicature Act, 1873*, with the revised procedural rules, it became apparent that general principles connected many of what were previously thought to be distinct areas of the law. In the context of contract, for example, a modern lawyer reading cases from before 1873 cannot escape the theoretical structure developed after that time, but it is important to remember that early decisions reflect pragmatic solutions to cases that were only later explained in terms of underlying, unifying principle.

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[11] *Supra*, Chapter II, n. 7, 190.

[12] P.S. Atiyah, *Pragmatism and Theory in English Law* (1987) 170.

Set-off has never been subject to this kind of rethinking or analysis. If one listens closely to the House of Lords in *Aries Tanker* as they endorse one rule of set-off for charter agreements and another, inconsistent, rule for the sale of goods, the clanking of medieval chains can be dimly heard.

In the following section, we attempt to identify some of the reasons which might be put forward to support the position adopted by the current law. It is useful to remember, however, that this kind of analysis is not to be found in the cases. Courts tend to confine their role to ascertaining what the law once was, without concern for whether it makes sense today or, indeed, whether it ever did.

E. Justifications for Limiting Cross Demands that May be Raised Against a Successor in Interest

The current law limits cross demands that may be set-off. In this section, we explore arguments that might be raised in support of the current law. It should be kept in mind, however, that the issue addressed in this Report is whether broader rights of set-off should be adopted. Why should set-off not apply to all cross-obligations?

1. Rights Of The Successor In Interest

When a third party is entitled to proceed on a demand originally owed to another person, it may be argued that cross demands that are unenforceable against him should not be allowed to diminish the value of his demand. The obligor should proceed against the assignor to recover what the assignor owes him.

This is a position that the law has never adopted.[13] For one reason, unless the obligor is permitted to raise a cross demand to diminish or extinguish the demand of the successor in interest, in many cases the obligor will recover nothing. Often, for example, the successor in interest becomes entitled to enforce the demand because of the insolvency of the party originally entitled to do so.[14]

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[13] *Supra*, n. 6.

Nevertheless, the successor in interest is essentially a stranger to the dispute from which the obligor's cross demand arises. For that reason, there must be a good reason to allow an obligor to raise a cross demand to diminish the value of the demand the successor in interest seeks to enforce. The law adopts the view that set-off should be available only when the cross demand is for debt, or arises from the same (or a related) transaction as the principal demand. Only in these circumstances should a defendant's cross demand affect the rights of a successor in interest.

2. NEEDS OF COMMERCE

In support of the current law, it may also be argued that the circumstances in which a third party becomes entitled to proceed on a demand are, from the perspective of commerce, of sufficient importance to require special protection. Three common situations where a third party becomes involved are the assignment for value, bankruptcy (assignment for the benefit of creditors) and receivership (assignment as security). In the cases of assignment and receivership, the third party has purchased the right to proceed on the demand. In the case of bankruptcy, the trustee in bankruptcy becomes entitled to enforce the demand on behalf of the creditors of the bankrupt.

In each case, it should be recognized that it is important to commerce for the third party to be able to enforce the demand. In the assignment or receivership case, for example, the party originally entitled to enforce the demand has a property right that he has sold or pledged to secure money he has borrowed. Limiting the rights of a third party to proceed in these cases may impair the ability to raise money or credit on the basis of obligations a person is owed. This is likely to be a matter of concern to the person originally entitled to enforce the demand.

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[14] *Infra*, nn. 30-34.

In bankruptcy, the trustee in bankruptcy must be able to enforce obligations owed the bankrupt in order to wind up his affairs effectively.

It may be argued, consequently, that in each of these cases, commerce requires that limitations be placed on the kinds of cross demands that may be raised to diminish or extinguish the value of the principal demand in the hands of the successor in interest.

3. INABILITY OF SUCCESSOR IN INTEREST TO PROTECT HIMSELF FROM CROSS DEMANDS

Where a third party "purchases" the right to proceed on a principal demand another argument may be raised. Unless, as the current law does, limits are placed on rights of set-off, a third party may find it difficult to protect himself. He will be less willing to purchase the right to proceed on a demand if he cannot ascertain its value with precision, and that will be impossible to do if he cannot be sure of the cross demands that may be raised to diminish it. Limiting rights of set-off in this context protects the marketability of claims as well as their value. An approach which permits wider rights of set-off might discourage assignees and lenders from accepting an assignment for value or as a security, or drastically affect the valuation of claims and the consideration they are prepared to give for an assignment.

4. RIGHTS OF UNSECURED CREDITORS

When the assignment is the result of bankruptcy, it is often said that the trustee in bankruptcy stands in the shoes of the bankrupt.[15] For the most part, only those rights which might have been exercised by the bankrupt are available to the trustee in bankruptcy.[16]

The law, however, recognizes exceptions to this principle on the basis that the trustee in bankruptcy represents the bankrupt's unsecured creditors.[17] Set-off in this context seems to be premised on the view that the contest is not really between the trustee in bankruptcy and the obligor, but between unsecured creditors of the bankrupt and the obligor. Wider rights of set-off might be perceived as prejudicing unsecured creditors too greatly.

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[15] *Re McKenster*, (1985) 58 C.B.R. 308 (N.S.S.C., T.D.); *Re J.W.O. Enterprises Ltd.*, (1981) 38 C.B.R. 244 (Man. Q.B.); *Re Otto Grundman Implements Ltd.*, (1969) 13 C.B.R. 322 (Man. C.A.).

[16] *Re Bondar*, (1986) 61 C.B.R. 120 (Alta. Q.B.); *Re Media Corp.* v. *Lando and Chaiton*, (1984) 49 C.B.R. 217 (Ont. S.C.); *Churchill Pulpmill Ltd.* v. *Gov't. of Manitoba*, (1977) 24 C.B.R. 116 (Man. Q.B.); *Re Lumberking Home & Garden Centre Ltd.*, (1975) 20 C.B.R. 180 (Ont. S.C.).

[17] For example, a trustee in bankruptcy may apply to set aside transactions entered into by the bankrupt before a receiving order was made which the bankrupt could not object to: *see Report on Fraudulent Conveyances and Preferences* (LRC 94, 1988).

5. SUMMARY

There are a number of points that can be raised in favour of the current restrictions on rights of set-off against a successor in interest. Indeed, it might well be argued that a more restrictive approach than that adopted currently is in order. It will be seen, however, that a number of arguments can also be marshalled in favour of wider rights of set-off.

F. Arguments in Favour of Wider Rights of Set-off

1. PREJUDICE TO OBLIGOR

Viewed from the perspective of the obligor, the current law, which limits the kinds of claims that may be set-off, often operates unfairly. The successor in interest is protected at the cost of the obligor. Where there is a receivership or a bankruptcy, for example, an obligor who is not entitled to set-off his claim must satisfy the obligation he owes in full, and then share with other unsecured creditors in whatever remains of the insolvent's estate after the claims of secured and preferred creditors are satisfied. Usually, the unsecured creditors of an insolvent receive, if anything, only a fraction of what they are owed.

2. ALTERNATIVE METHODS OF PROTECTION AVAILABLE TO THE SUCCESSOR IN INTEREST

It was mentioned above that it may be difficult for a successor in interest to protect himself against cross demands that an obligor might raise. That point, considered in isolation, suggests that there is a need to limit the cross demands that may be raised against a successor in interest. It must not, however, be overstated.

There are a number of techniques which a successor in interest may adopt to protect himself. He may, for example, contact the obligor and ascertain what cross demands are outstanding. The obligor, on the other hand, has no method available to him to avoid the prejudice that arises when a successor in interest acquires the right to proceed against him.

An assignee may also enter into a recourse agreement with the assignor under which he can compel a reassignment if the obligor raises a set-off. Or the assignor may agree to indemnify the assignee.

Moreover, the law affords a successor in interest two methods of limiting cross demands that may be raised against him. Any cross demand arising after the entitlement of the successor in interest has vested (other than one arising from a transaction related to the principal demand) may not be set-off.[18] If the successor in interest acquires his rights by an assignment for value, for example, he perfects his interest by giving the obligor notice.[19] No cross demand arising after notice can be set-off against the assigned demand.[20]

Commerce requires a medium of exchange. Money performs that function for many purposes, but in some cases it is inconvenient to use money. Instead, a person will prepare an instrument (such as a cheque, promissory note or other bill of exchange) which will entitle a "holder in due course" to receive money, immediately or at some designated time, from the person making the instrument or from a third party, such as a bank. Instruments of this nature may be transferred to others and function much like money. They are called "negotiable instruments." Generally, their transfer is not subject to the equities, unlike the transfer of other kinds of claims.[21] A successor in interest, desiring to receive an assignment free of demands which can be raised against the assignor may structure his business arrangements in terms of negotiable instruments. If he does so, he will be a "holder in due course" and an assigned claim will be immune to unknown equities that might otherwise attach to an assignment.

This last point is one of some significance. For many centuries the law refused to permit the assignment of choses in action, other than negotiable instruments. Equity recognized assignments and provided a procedure for their enforcement, although great care was taken to ensure that the assignee stood in no different position than the assignor.[22] From this early position, the law seems to have turned 180 degrees. Unconsciously, courts appear to be assimilating the law governing the assignment of choses in action to that which governs negotiable instruments.[23] Courts are doing something they ought not to be doing. The exceptional nature of negotiable instruments justifies their special treatment. There is no need to expand the principles of law that apply to negotiable instruments to embrace all choses in action.

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[18] *Supra*, nn. 6 and 7.

[19] *Ibid.*

[20] *Ibid.*

[21] *Supra*, Chapter III, n. 12.

3. THE DISTINCTIONS DRAWN BETWEEN DEBT AND DAMAGES ARE ILLOGICAL

Even if an argument can be made that successors in interest should be protected from some kinds of cross demands, the approach currently adopted by the law seems to be illogical. It provides that a cross demand for debt, and any claim arising from a transaction related to the principal demand, may be set-off. In terms of principle, perhaps an argument can be raised for limiting set-off to related demands. That position would seem to identify at least some cases where obligations between persons should be regarded on a net basis. However, it doesn't explain why set-off should be available for unrelated debts.

It might be argued that debt need not be related to the principal demand because, when debt is involved, the parties rely on rights of set-off as a matter of course. It is only fair, consequently, that a successor in interest should be subject to a cross demand for debt.

The flaws in such reasoning are obvious. There is no reason to suppose that parties, in their mutual dealings, distinguish between the kinds of obligations that exist between them. Where one person has a claim for damages for breach of contract, it is unlikely that he thinks of the obligations he is owed as differing in any material way from debt.[24]

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[22] *Supra*, nn. 6 and 7.

[23] *See, e.g.*, *Coba Industries Ltd.*, *infra*, n. 26, where Macfarlane J.A. spoke of protecting the "innocent assignee."

[24] It is interesting to note that once an unliquidated claim has been reduced to judgment it is a liquidated claim and can be set-off: *See, e.g.*, *Edwards* v. *Hope*, (1885) 14 Q.B.D. 922 (C.A.); *Kallio* v. *Russell Timber Co.*, [1942] S.C.R. 346; *Kohen* v. *Culley Breay & Dover Ltd.*, (1925) 57 O.L.R. 533 (S.C., App. Div.); *Lawrence* v. *Hayes*, [1927] 2 K.B. 111. The nature of the claim, consequently, is ultimately irrelevant. The courts once "veered away from any kind of legal relief which involved estimation" (L.L. Fuller, W.R. Perdue, "The Reliance Interest in Contract Damages," (1936) 46 Yale L. Rev. 52, 68) and this long since rejected bias is reflected in the distinction drawn between liquidated and unliquidated demands in the law of set-off.

The only reason that the law of set-off distinguishes between a claim for debt and one for damages is historical. In terms of the former law, many distinctions between liquidated and unliquidated claims were acknowledged. It is probable that the Statutes of Set-off first created the exception for debt because it was an obligation that the courts did not need to quantify. Even if this position is correct in principle, the current law does not accept it wholly. If A has a claim for debt against B, it may make sense to restrict B's right to set-off a claim for damages against A on the basis that it is difficult to assess what B's claim is. It makes no sense, however, when A has a claim for damages, to limit B's right to set-off a claim for debt. B's claim does not present problems of assessment. The two situations are entirely different, and yet the law of set-off draws no distinction between them.

Today, the courts are not overwhelmed by problems of quantifying damages. There is no reason for distinguishing between debt and other kinds of demands. The Law Reform Committee of South Australia, acknowledging this position, proposed that the law be revised to permit the set-off of any liquidated or unliquidated claim:[25]

> However the position may stand with regard to the English rule of Court just referred to, it is an inescapable fact that, whether or not *Hanak* v. *Green* was rightly decided in the first

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[25] 75th Report, *Relating to the Reform of the Law of Set-off*, 9. A similar position has been adopted by the *Uniform Commercial Code: Uniform Laws Annotated (1981)* and the (U.S.) *Restatement of the Law of Contracts* 2d (1981) vol. 3. Section 9-318(1) of the U.C.C. provides as follows:

> 9-318(1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in Section 9-206 the rights of an assignee are subject to
>
> (a) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and
>
> (b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

"Contract" is accorded a broad meaning, and may encompass performance expected by reason of the course of dealing or usage of trade or course of performance as provided in the U.C.C., s. 1-201(3), and, perhaps, related contracts: *see* L.D. Bishop, "Commercial Transactions: Protection of the Account Debtor Within and Without U.C.C. s. 9-318(1)," (1982) 35 Oklahoma L. Rev. 415, 417. This last issue seems to have presented American courts with many of the difficulties Commonwealth courts have faced in determining whether transactions are sufficiently related to permit the set-off of competing claims arising from them: *supra*. Section 38 of the *Model Uniform Personal Property Security Act*, adopted by the Uniform Law Conference of Canada in 1983 is based on s. 9-318(1). With respect to claims unenforceable until a future time, the (U.S.) *Uniform Commercial Code*, provides that an account debtor can assert against an assignee "any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment": s. 9-318(1)(b). This provision, however has been interpreted to mean that a defence or claim "accrues" when the account debtor is entitled to enforce it. The claim or defence, consequently, must be due, or the assignor must be in breach, before notice of the assignment is received: *Seattle-First National Bank* v. *Oregon Pacific Industries*, (1972) 262 Or. 578, 500 P. 2d 1033. Ironically, it has been suggested that this narrow construction can be avoided by relying on rights of equitable set-off: *see* Bishop, *supra*.

> place, Courts in England, Australia and New Zealand have used it to widen the categories of set-off. Once one gets to the position where some unliquidated demands can be the subject of a set-off, there is really no logical reason why all cannot be. The purists used to cite as their stock example the alleged impossibility of setting off unliquidated damages for libel due to a defendant by a plaintiff against a liquidated claim by the plaintiff against that defendant. Really it is impossible to maintain the distinction. If A claims money from B and B has a right to have a valid claim against A assessed and quantified, there is no logical reason why B should not have his claim quantified and set off against the demand by A, unless, as Maitland said, the forms of action are to rule us from their graves.

It would appear, consequently, that the law should either recognize that only related demands may be set-off, or that any demands may be set-off. The current law cannot be supported, except as some kind of curious compromise between these two positions.

4. COMPLEXITY OF THE LAW

Even if a case can be made out which supports the distinctions drawn by the current law, it should be recognized that the price, in terms of the complexity of the law, is substantial. The case law on set-off is intricate and, in many respects, irreconcilable.[26] When the law produces inconsistent results and is uncertain in its application, it is usually a sign that the policies it advances have not been fully worked out.

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[26] Consider the following issues:

a) Kinds of set-off: Most authorities agree that there are three kinds of set-off: statutory set-off, abatement (the rule in *Mondel* v. *Steel*, (1841) 8 M. & W. 858, 151 E.R. 1288), and equitable set-off: *see, e.g.*, *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14 (B.C.C.A.); *Hanak* v. *Green*, *supra*, n. 1 at 18-9 (C.A.). However, in *Aboussafy* v. *Abacus Cities Ltd.*, (1981) 124 D.L.R. (3d) 150, 156 (Alta. C.A.), commonly regarded as a leading case, it was said that there are only two kinds of set-off: statutory set-off and abatement. No cases fall within equitable set-off that do not fall within abatement. This proposition is clearly in error. *Mondel* v. *Steel*, *supra*, is an example of abatement at common law. It has absolutely nothing to do with equitable set-off. In *Aboussafy* v. *Abacus Cities Ltd.*, *supra*, it was said "Nothing much would turn on this save that this categorization encourages the dubious proposition now advanced by the appellant" (that a claim arising from a transaction related to the principal claim may be set-off, exactly what was permitted in *Holt* v. *Telford*, *infra*, Chapter V, n. 1). *See also Davis* v. *Spectrix Microsystems Inc.*, (1987) 63 O.R. (2d) 151, where the abatement cases are incorrectly classed as a sub-set of equitable set-off.

b) Received Law: Whether the Statutes of Set-off are in force in a particular province depends upon whether they are part of the received law. The British Columbia Court of Appeal held in 1915 that the Statutes of Set-Off are no longer in force in this province: *Victoria Saanich Motor Transportation Co.*, *supra*, n. 1, a decision of a five member panel of the Court of Appeal. In 1983, however, the British Columbia Court of Appeal, without referring to *Victoria Saanich Motor Transportation Co.*, *supra*, held that the Statutes of Set-Off were part of the received law: *Canadian Imperial Bank of Commerce* v. *Tuckerr Industries Inc.*, (1983) 149 D.L.R. (3d) 172, 46 B.C.L.R. 8 (C.A.).

c) Loss of Mutuality on an Assignment: statutory set-off is unavailable except for "mutual debts." Some courts hold that mutuality is lost on assignment, others that it is not: *see supra*, Chapter II, n. 5. (con't.)

5. THREE POLICIES FAVOUR WIDER RIGHTS OF SET-OFF

In addition to the arguments already canvassed, it should be observed that the current law of set-off is inconsistent with three policies generally endorsed by the law.

(a) *Assignee Should Occupy No Better Position than Assignor*

The principles that control when a set-off is available against a successor in interest were developed with an eye to the position that would have existed had the proceedings been brought by the assignor.[27] It was perceived to be unfair that a successor in interest could be in a better position than the assignor. The law, in its inception, was developed to ensure that the same result ensued whether a claim was brought by a successor in interest or by the party originally entitled to enforce the demand.

The current law, however, appears to have abandoned this policy. If the assignor had brought proceedings against the obligor, the obligor could raise by counterclaim any cross demand he was owed that was convenient to hear in the same proceedings. Proceedings brought by a successor in interest, however, are only subject to those cross demands that a court of equity would have permitted to be raised before the introduction of rights of counterclaim. In many cases, the obligor is in a much worse position if the claim is brought not by the original party but by a successor in interest. It is difficult to see why the commercial value of an assignment, or the rights of creditors, should be heightened at the expense of the obligor.

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26. (cont.) d) What is meant by the statement that an assignment is subject to the "equities?" Is that the same thing as saying that an assignment is subject to cross demands that equity would have permitted to be set-off against the original party entitled to enforce the assigned demand? Modern courts appear to hold that the "equities" are determined by the law of set-off. Spry suggests that this is incorrect. "Equities" is a broader concept than equitable set-off: *see supra*, Chapter II, n. 11.

e) Liquidated and Unliquidated Claims: In *Coba Industries Ltd.*, *supra*, at 22, in a summary of the principles of equitable set-off it was said that "unliquidated claims are on the same footing as liquidated claims." The statement was also quoted with approval by the Supreme Court of Canada. But what does it mean? As we have seen, equity applied one set of principles to the set-off of a liquidated demand against a liquidated demand and another to the set-off of demands where one or both were unliquidated. It is incorrect, consequently, to say that "unliquidated claims are on the same footing as liquidated claims," unless the court is amending the principles of set-off. Did the British Columbia Court of Appeal and the Supreme Court of Canada mean that a liquidated demand can only be set-off against a liquidated demand if it satisfies the related transactions test? Or did they mean that unliquidated demands can be set-off by analogy to the Statutes of Set-Off? Can any meaning be assigned to the statement "unliquidated claims are on the same footing as liquidated claims?"

27. *Supra*, nn. 2 and 6, and Chapter II, n. 7.

(b) Avoid Multiplicity of Actions

One aim of the great legal reforms of the latter part of the nineteenth century was the avoidance of a multiplicity of actions.[28] The introduction of rights of counterclaim were aimed at ensuring that disputes between the parties were concluded with a minimum number of judicial proceedings. It was decided, consequently, that insofar as it was practical, all demands between the parties should be capable of being heard in the same proceeding. This position was based, essentially, on the view that the net position of the parties should be preferred. The failure to apply this policy to proceedings brought by a successor in interest is inexplicable.[29]

(c) Position When Insolvency a Factor

The first rights of set-off acknowledged at law were introduced by legislation which applied on a bankruptcy.[30] The view was held that when a person became insolvent the mutual debts and credits that existed between the insolvent and another should be taken into account.[31] Under this approach, the net position between the parties determined what had to be paid, either by the insolvent or the other party. The unfairness of requiring a person to satisfy a demand, but go without a remedy on a cross demand, led to the development of these principles.[32] The argument that permitting set-off in these circumstances gave an unsecured creditor priority over other creditors was dismissed:[33]

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[28] *Supra*, Chapter I, n. 1.

[29] The term "net position" does not seem entirely appropriate when speaking of a dispute between a successor in interest and an obligor, and some discussion of this point is called for. The law has never had to define whether set-off between original parties defines the "net position" of the remedies available, or to define the rights or obligations of the parties on a net basis. Suppose A owes B $100 and B owes A $150. Does set-off operate so that, in law, there is only one obligation (B owes A $50)? Or does it operate by acknowledging that each party is owed obligations in full which will be satisfied by the payment of $50?

There is no need to define the theoretical operation of set-off between original parties. It seems to matter, however, when a successor in interest is involved. If set-off only defines the remedy available, this would not appear to be good reason for limiting the right of the successor in interest to receive judgment in full. It should be remembered, however, that the right of an assignee to proceed in his own name is a fairly recent development. Technically, on an assignment, the successor in interest stands in the shoes of the assignor, and this was clearly reflected by the former law which required an action on an assigned claim to be brought in the assignor's name. The concept of "net position," whether it defines the remedy available or creates one net right or obligation, consequently, applies equally when a successor in interest is involved.

[30] *Supra*, Chapter II, n. 12.

[31] *Supra*, Chapter II, n. 13.

[32] *See, e.g., High on Injunctions*, (4th ed., 1905) vol. I, 233.

[33] *Judicial and Statutory Definitions of Words and Phrases*, (1905) vol. 7, 6439. *See also James* v. *Kynnier*, (1799) 5 Ves. Jun. 108, 110, 31 E.R. 496, 497: (cont.)

> Where parties have had dealings so as to produce mutual debts or credits or reciprocal demands growing out of the same transaction, it is the balance only which exists as the debt; and, in the case of bankruptcy of one of the parties, a set-off of their mutual demands is not a means of paying one debt in preference to other debts which the bankrupt owes, for, to the extent of the demands set off or compensated, there was no debt. From the moment they were contracted they extinguished each other. Hence, the operation of a set-off is, not to pay, but to ascertain a debt made up of the difference between the amounts of respective debits and credits.

Modern courts when faced with issues of set-off arising on an insolvency seem to lose sight of the policies the law was designed to promote. The distinction, acknowledged for centuries, between principles of equitable set-off, and principles of set-off when an assignment occurs by reason of insolvency, has been forgotten by modern courts.[34]

6. CONCLUSION

The preceding discussion has attempted to identify arguments in favour of the current law and to examine these arguments critically. The points that can be raised in support of the current law are unconvincing. The law of set-off is flawed from the perspectives of principle and of policy. No convincing rationale exists for altering the rights of an obligor when a successor in interest becomes entitled to enforce a claim. It is, to say the least, unusual for the law to hold that an obligor's rights against a successor in interest are those rights he would have had against an assignor before 1873, long after the law had altered the position between an obligor and assignor.

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33. (cont.)

> Is there any doubt, that, where there are upon account mutual credits between two parties, though they cannot set off at law, yet it is the common ground of a bill [in equity]....When there comes a case of bankruptcy, it is much stronger. Between solvent persons, there might be a ground to say, indulgence was given, the credit extended; and therefore that credit ought to be continued. But the moment a bankruptcy comes the account is to be settled.

[34] *Supra*, Chapter II, n. 14. The manner in which Bill C-17, second session, Thirty-second Parliament, 32 Elizabeth II, 1983-84, the most recent in a series of bills to reform bankruptcy legislation, deals with set-off is of interest:

> 246. (1) Where two persons have debts owing, one to the other, and an arrangement or bankruptcy order is made in respect of either of them,
>
> (a) an account shall be taken of such debts;
>
> (b) any debt that is owing shall be set-off against any debt that may be claimed; and
>
> (c) the balance of the account may be claimed as a debt or shown as a debt payable.

The definition sections of the Bill operate so that any obligation to pay money, whether liquidated or not, absolute or contingent, certain or disputed may be the subject of set-off.

What is needed, therefore, is legislation to ensure that an obligor is not prejudiced by the law. In our view, this can be accomplished by replacing the current law of set-off with rights of counterclaim altered to ensure that they operate so as to define the net position between the parties. When a successor in interest sues on a demand, the obligor should be able to raise any matter which could have been raised against the assignor, to diminish or extinguish the claim of the successor in interest.

CHAPTER V

DEMANDS WHICH BECOME PAYABLE AFTER AN ASSIGNMENT

A. Introduction

The law considers two factors when determining whether a cross demand may be set-off: the nature of the claim, and when it arises. Our discussion in this chapter focuses on the temporal aspect of set-off. A number of technical and analytic problems arise when dealing with cross demands which are not fully enforceable or complete until after an assignment of a principal demand takes place.

For convenience, we refer to these kinds of cross demands as "maturing" or "future" cross demands. The various kinds of cross demands that satisfy these general designations are described with some rigor in this chapter.

Maturing cross demands were recently considered by the Supreme Court of Canada in *Holt* v. *Telford*,[1] a decision which serves as a useful point of departure for our examination of this area of the law.

B. *Holt* v. *Telford*

Holt v. *Telford* involved two dispositions of land in Alberta.[2] Mr. and Mrs. Telford ("T") purchased property from a corporation, Canadian Stanley ("C"). Part of the purchase price was secured by mortgage. At the same time, C purchased property from T. Part of that purchase price was also secured by a mortgage. The mortgage in favour of C was for $50,000 more than the mortgage in favour of T. C assigned its mortgage to Holt ("H"). T defaulted under the mortgage and H began foreclosure proceedings. T attempted to set-off the mortgage debt owed by C. If the set-off was permissible, then

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[1] [1987] 2 S.C.R. 193, [1987] 6 W.W.R. 385.

[2] A curiosity in *Holt* v. *Telford*, not referred to in the court's decision, is why the parties did not set-off their demands immediately, so that Canadian Stanley acquired its property with clear title, and the Telfords theirs subject to a mortgage for $50,000. On the facts of the case, it might be argued that the parties had implicitly agreed that these cross demands could not be set-off, an option that was open to them.

T only had to pay H $50,000 (the difference between the two mortgages).[3]

C. Demands Accruing Due After an Assignment

In *Holt* v. *Telford*, the Supreme Court of Canada found that there are only three situations where set-off is available for a liability that is not payable until after notice of the assignment is received:

(i) where the original parties agreed that it could be set-off;

(ii) where it is in existence before notice, although not payable until after; or

(iii) where it derives from a transaction inter-related to the transaction from which the principal claim arises.

It was found that there was no agreement between the original parties to allow the set-off.[4] The Supreme Court of

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[3] Under Alberta legislation, an individual is not personally liable for a debt secured by mortgage: *Law of Property Act*, R.S.A. 1980, c. L-8, s. 41(1), 42, 43(1). The lender's remedies are confined to the land by statute. It was argued that, since the claim against T was unenforceable, there was no cross demand to set-off: *See, e.g.*, *Edmonton Airport Hotel Co.* v. *Credit Foncier Franco-Canadien*, [1965] S.C.R. 441; *Renner* v. *Racz*, [1972] 1 W.W.R. 109 (Alta. S.C., App. Div.). This argument was dealt with briefly, *supra*, n. 1., 217 (S.C.R.), 403 (W.W.R.):

> Section 41 does not create an unenforceable debt. Section 41 does not extinguish or satisfy the debt. It merely precludes the remedy by way of a personal judgment against the mortgagor on the covenant. The mortgagee may still pursue the remedy of foreclosure. Therefore, both the Telfords and Canadian Stanley have enforceable debts. It is true that pursuant to the statute a different range of remedies is available to an individual from that available to a corporation. Set-off does not however require either symmetry of remedies or of amounts.

This part of the decision is unquestionably correct. It cannot be said that a debt is unenforceable because a person is not personally liable for it, where it may be enforced against property he owns.

[4] T was unable to provide evidence of any such agreement. In past decisions, some courts have been prepared to infer such an agreement from the course of dealings between the parties. It was mentioned earlier that it is difficult to see how there could be such an agreement, when the parties chose not to set-off their cross demands when the properties were conveyed.

The issue of whether there was an agreement to set-off is only relevant where set-off is unavailable at law or in equity. This does not emerge clearly from the decision of the Supreme Court of Canada. The usual rule is that there is no need for an agreement to support rights of set-off: *Gilbert-Ash (Northern) Ltd.* v. *Modern Engineering (Bristol) Ltd.*, [1974] A.C. 689, 717 (H.L.), [1973] 3 All E.R. 195; *see also B.I.C.C.* v. *Burndy Corp.*, [1985] 1 All E.R. 417 (C.A.). In fact, the law requires an express agreement to prevent a set-off. The test of related transactions to establish an equitable set-off seems to reflect the view that, balancing the rights of assignee and debtor, it is unfair to deprive the debtor of set-off in those special cases where that was impliedly or expressly part of the dealings between the parties. In *Canadian Imperial Bank of Commerce* v. *Tuckerr Industries Inc.*, (1983) 149 D.L.R. (3d) 172, 46 B.C.L.R. 8 (B.C.C.A.) it was said that a set-off may exist if it has been relied upon. The antithesis of this view seems to be reflected in both *Gilbert-Ash (Northern) Ltd.* v. *Modern Engineering (Bristol) Ltd.*, *supra*, and *Rother Iron Works Ltd.* v. *Canterbury Precision Engineers*, [1974] 1 Q.B. 1, [1973] 1 All E.R. 394 (C.A.) which proceed on the basis that rights of set-off are naturally part of the dealings between the parties. That is the normal basis upon which business is conducted. Agreement is only relevant where the parties wish to enlarge or restrict rights of set-off. (con't.)

Canada had to determine whether set-off was available under one of the other two exceptions.

D. Demands in Existence Before Notice

1. THE SUPREME COURT OF CANADA

The portion of the decision in *Holt* v. *Telford* that deals with unmatured debts is curious indeed. Madame Justice Wilson reviewed in some detail case authority which permitted the set-off of debts that were in existence before, although payable at some time after, the entitlement of the successor in interest vested. *In re Pinto Leite and Nephews*[5] was cited with approval, and the following statements of law were endorsed:[6]

> It is, of course, well settled that the assignee of a chose in action...takes subject to all rights of set off which were available against the assignor, subject only to the exception that, after a notice of an equitable assignment of a chose in action, a debtor cannot set off against the assignee a debt which accrues due subsequently to the date of notice, even though that debt may arise out of a liability which existed at or before the date of the notice; but the debtor may set off as against the assignee a

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4. (con't.) It is open to the parties to agree whether or not particular obligations may be set-off: *Freeman* v. *Lomas*, (1851) 9 Hare 109, 68 E.R. 435; *In re Goy & Co.*, [1900] 2 Ch. 149, 154; *Mangles* v. *Dixon*, (1852) 3 H.L.C. 702, 10 E.R. 278; *In re Agra and Masterman's Bank*, (1867) L.R. 2 Ch. App. 391 (C.A.); *Phoenix Assurance Co.* v. *Earls Court (Ltd.)*, (1913) 30 T.L.R. 50 (C.A.); except, perhaps, in bankruptcy: *Halsbury's Laws of England*, (4th ed.) vol. 3, para. 751 *et seq.* The agreement may be express or implied. *Watson* v. *Mid Wales Ry Co.*, (1867) L.R. 2 C.P. 593; *Smith* v. *Parkes*, (1852) 16 Beav. 115, 119, 51 E.R. 720, 722. In *Rother Iron Works Ltd.* v. *Canterbury Precision Engineers Ltd.*, *supra*, the plaintiff owed the defendant £124. The plaintiff had sold goods to the defendant for £159. The goods were ordered before, but not delivered until after, the appointment of a receiver. There was no mutuality of parties, nor were there cross demands arising from the same or similar contracts. Nevertheless, the court found that there was an implied agreement to set-off the obligations:

> ...if the obligation of the defendant to pay £159 be regarded as a chose in action on its own it never, in our view, came into existence except subject to a right to set-off the £124 as, in effect, payment in advance. That which became subject to the debenture charge was not £159, but the net claim sustainable by the plaintiff of £35.

Supra, 6 (Q.B.), 396 (All E.R.); *see also Sigurdson* v. *Regina*, (1982) 33 B.C.L.R. 190 (C.A.). In some cases this view of set-off has been overlooked. Instead, the principle claim is regarded as being assigned to the debenture holder before the pre-existing set-off can attach to it: *Tuckerr Industries Inc., supra*; *see also* P.C. Lee, "The Law of Set-off," Receivers, Continuing Legal Education, June 1985.

5. [1929] 1 Ch. 221. *See also In re The Progress Assurance Co.; Ex p. Bates*, (1870) 39 L.J. Ch. 496 (on a winding up); *West Street Properties Pty. Ltd.* v. *Jamison*, [1974] 2 N.S.W.L.R. 435 (S.C.); *Christie* v. *Taunton*, [1893] 2 Ch. 175; *Coopers & Lybrand Ltd.* v. *Lumberland Building Materials Ltd.*, (1983) 49 B.C.L.R. 239 (S.C.); *Biggerstaff* v. *Rowatt's Wharf, Ltd.*, [1896] 2 Ch. 93 (C.A.). For a very sophisticated analysis of the issues arising for claims which exist before an assignment, but which are not payable or ascertainable until, or are contingent upon events occurring, after assignment, *see In re Charge Card Services Ltd.*, [1987] 1 Ch. 150. Note that this case dealt with the English bankruptcy provisions which permit the set-off of claims arising from the mutual dealings of the parties, a much wider concept than is currently applied in Canada. It is, however, arguable that these provisions should apply on a bankruptcy: *supra* Chapter II, nn. 12-16.

6. *Supra*, n. 1, 209 (S.C.R.), 397-8 (W.W.R.); *In re Pinto Leite & Nephews*, *ibid.*, at 233 and 236.

> debt which accrues due before notice of the assignment, although it is not payable until after that date...[236] [W]hen the debt assigned is at the date of notice of the assignment payable in futuro, the debtor can set off against the assignee a debt which becomes payable by the assignor to the debtor after notice of assignment, but before the assigned debt becomes payable, if, but only if, the debt so to be set off was debitum in praesenti at the date of notice of assignment.

The concept described above is reflected in the Latin phrase, *debitum in praesenti, solvendum in futuro*, which Jowitt defines as "owed at the present time though payable in the future."[7] It is important to keep in mind that whether a debt is "owed" or in existence has nothing to do with whether it is payable.[8] The concept of *debitum in praesenti, solvendum in futuro* has also been defined as follows:[9]

> A debt or obligation complete when contracted, but of which the performance cannot be required till some future period.

The following example demonstrates how the exception accorded *debitum in praesenti, solvendum in futuro* operates:

January 1, 1988 - A buys goods from B for $100 payable March 1, 1988.

February 1, 1988 - B buys goods from A for $100 payable June 1, 1988.

March 1, 1988 - B assigns the debt he is owed to C, who sues A on it.

A asserts a set-off of the debt B owes him.

Even though the debt owed to A is not payable until June 1, it is a present debt, and on the authority of *In Re Pinto Leite*, A should be allowed a set-off for it against C. So long as the debt is in existence before notice of an assignment is received, it does not matter when the debt is payable.

Having approved this authority, however, the Supreme Court of Canada proceeded to find that set-off was not available for a debt, in existence before, but not payable until after, notice of the assignment of a cross demand, if the debt is secured by a mortgage:[10]

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[7] John Burke, *Jowitt's Dictionary of English Law*, (2nd ed.) 562.

[8] *See* the definition of "owing" in *Black's Law Dictionary*, (5th ed.) 996.

[9] *Ibid.*, 363.

[10] *Supra*, n. 1, 214-5 (S.C.R.), 401 (W.W.R.).

> The date of notice of assignment was accordingly March 13, 1981. Under the original schedule of payments the only debt which accrued due prior to March 13, 1981 was the January 31, 1981 payment of $50,000 from the Telfords to Canadian Stanley. The debts which the Telfords are seeking to set-off did not accrue due before the date of the notice of assignment. Thus, the debts can be set-off only if the Telfords can demonstrate that they arise out of the same contract or closely inter-related contracts.

The analysis in this portion of *Holt* v. *Telford* is not wholly satisfying. It consists, in its entirety, of the conclusion that obligations which are not payable have not accrued due and, therefore, may not be set-off against an assignee. The issue before the court, however, was whether the obligation was in existence in the sense that it was owing, not whether it was payable, before notice of the assignment.

It is difficult to see why a mortgage debt is not a *debitum in praesenti, solvendum in futuro*. Madame Justice Wilson seems to adopt the view that only debts which are payable before notice of assignment may be set-off, unless from inter-related contracts. Earlier in the judgment, however, it is clearly stated that the requirement is not that they be payable, only that they be owing.

Holt v. *Telford* seems to stand for one of two propositions. Perhaps the exception formerly accorded debts in existence but not payable until a later date has been removed. This does not seem likely.

Alternatively, *Holt* v. *Telford* may stand for the proposition that, while an existing simple debt may be set-off, even if it is payable after notice of an assignment, the same debt may not be set-off if secured by a mortgage. Again, it is difficult to see on what basis such a distinction could be made. A mistake seems to have occurred in *Holt* v. *Telford*.

2. EARLIER AUTHORITY

It is a mistake made in most modern cases dealing with the law of set-off. Only in *Holt* v. *Telford*, however, because of the very clear statements of principle made in that case, does the error become glaring. Nevertheless, time after time, in cases such as *Watson* v. *Mid Wales Railway Co.*,[11] *Business*

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[11] *Supra*, n. 4.

Computers Ltd. v. *Anglo-African Leasing Ltd.*,[12] *C.I.B.C.* v. *Tuckerr Industries. Inc.*,[13] and now *Holt* v. *Telford*, debts which were in existence before an assignment are not permitted to be set-off.

3. IN TERMS OF POLICY

(a) Accruing Due

When two people enter into a contract, each assumes obligations under it. It is called an "executory contract" until the performance of these obligations takes place. When all obligations under a contract have been completed, it is said to be executed.

Often, the obligations owed by one party will depend upon the performance by the other party of his obligations. For example, A agrees to buy 40,000 widgets from B for $.10 a widget. Until B delivers the widgets, A is not obligated to pay B. If B fails to deliver the widgets, however, he will be in breach of the contract.

A point of confusion in the law of set-off seems to arise from the vocabulary that is used. A similar confusion exists in the law governing the attachment of debts, where the courts have struggled with the same concepts for some decades.[14] The confusion lies in the meanings of the terms "accruing due", "owing" and "accrued due."

The concept of "accruing due" applies in one of two distinct circumstances. It may refer to the gradual accumulation of a right to proceed on an obligation, or it may refer to a period of time during which the ability to proceed on a vested right is deferred. To demonstrate the use of "accruing due" in the first case requires a change to our earlier example. Suppose the agreement provides that B will deliver the widgets in weekly installments. In this case, with each shipment of widgets, A's obligations under the contract to B are gradually accruing due. With each delivery, a portion of A's obligations have accrued due.

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[12] [1977] 1 W.L.R. 578 (Ch. D.).
[13] *Supra*, n. 4.
[14] *See Report on Attachment of Debts Act* (LRC 39, 1978).

To demonstrate the second sense of the term "accruing due" a further refinement to the example must be made. Suppose that A need not pay for the widgets until one month after delivery. In that case, upon B completing delivery, A's obligation to B to pay for the widgets is in existence. It is owing. It will not have "accrued due", however, until the month expires. Until that time, A's obligation is still "accruing due."

The discussion to this point may make the concept of "accruing due" seem more complex than it really is. That is the result of the imprecision of the term itself. It refers both to a gradual accumulation of an obligation, and to a deferral of the performance of an existing obligation.

In the law of set-off, the courts seem to confuse the deferral of performance of an obligation with the gradual accumulation of an obligation. This confusion lies at the heart of the decision in *Holt* v. *Telford*. It is important to distinguish between an obligation which is owing, although not payable until some future time, and an obligation which is accumulating and not owing.

There is no reason that an obligation which is owed, even though not yet payable, should not be capable of being set-off.[15] For the most part, the law of set-off allows this. There are a number of situations, however, where the courts have refused a set-off in analogous cases.

(b) Secured Debt

In *Holt* v. *Telford*, the Supreme Court of Canada acknowledged that a debt which was owed, but not yet payable, could be set-off. A debt secured by mortgage is owed, but payable at defined future times. It too should be subject to set-off. The court said, however, that the mortgage debt had not accrued due because it was not yet payable. It could not be set-off. There is little that can be said about this decision except that the court seems to have made a mistake. Securing a debt does not alter the fact that it is owed.[16]

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[15] *See, e.g., Parsons* v. *Sovereign Bank of Canada*, [1913] A.C. 160 (P.C.); *Biggerstaff* v. *Rowatt's Wharf, Ltd., supra*, n. 5; *Booth* v. *Hutchinson*, (1872) L.R. 15 Eq. 30; *Jack* v. *Kipping*, (1882) 9 Q.B.D. 113; *Mersey Steel and Iron Co.* v. *Naylor, Benzon & Co.*, (1882) 9 Q.B.D. 648, 9 App. Cas. 434 (liqu.); *In re Asphaltic Wood Pavement Co.*, (1885) 30 Ch. D. 216. On the other hand, it has been held that a claim for default where the debtor has not accepted the repudiation of the contract, or there has been no acceleration of payments due, may not be set-off: *Business Computers Ltd.* v. *Anglo-African Leasing Ltd., supra*, n. 12; *Tuckerr Industries Inc., supra*, n. 4.

(c) Obligations Which Appear to be Accumulating

In some cases the courts have characterized existing obligations between the parties as accruing due in the sense that they are gradually accumulating. This has happened in the case of a lease of real property and of a lease of equipment. In terms of the law, however, this kind of analysis is fundamentally incorrect.

(i) Lease of Real Property

Suppose A leases Blackacre from B for 2 years. The rent is $10,000, payable in equal monthly installments. Many people might look upon this as an example where both parties perform during the course of the lease. As one party performs his obligation, the obligation of the other to pay accumulates. They might think, for example, that each month that A permits B to occupy Blackacre, B becomes obligated to pay one month's rent.

This sort of analysis, however, is incorrect.[17] Essentially, A has sold B a time in the land. It is B's to use for two years. A has performed all of his obligations at the beginning of the lease. For convenience, the rent is payable in installments, but the arrangement is little different than if B had paid the whole of the rent in advance.[18] A lease is like a sale of goods where the purchase price is to be paid in installments.

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[16] *See Report on Limitations* (LRC 15, 1974).

[17] At least in terms of classical theory. Since the decision of the Supreme Court of Canada in *Highway Properties Ltd.* v. *Kelly, Douglas & Co.*, (1971) 17 D.L.R. (3d) 710, however, the position has been blurred by importing principles of contract law. Nevertheless, even adopting a contractual analysis, it is clear that a landlord performs his principal obligation under the contract in full by making the premises available. *See Working Paper on the Commercial Tenancy Act* (WP No. 61, 1988) Chapter V.

[18] When a lease is entered into, the landlord gives possession, thus satisfying his principal obligation under the lease. Various other contractual obligations may remain to be fulfilled. The tenant under the lease is now obligated to pay the full amount of the lease, although frequently the agreement will call for periodic payments, usually on a monthly basis. For example, T leases Blackacre from L for two years. The cost of the lease to T is $20,000, but this sum is payable in monthly installments. The sum is a present debt, but one which is not payable except at defined future times. This should be contrasted with an arrangement like a month to month tenancy. If T rents an apartment under an arrangement whereby the tenancy may be terminated on one month's notice by either the tenant or the landlord, then his obligations are confined to the period for which he has rented the premises. Even if it is contemplated that T will continue to rent for a year or more, his obligation to pay rent only arises at the beginning of each month he continues to occupy the premises without giving notice. Usually, in these arrangements, T will pay rent at the beginning of the month, but there should be no difference in principle between this arrangement, and one which calls for payment at the end of the month of tenancy. In each case, T becomes liable for the payment at the beginning of the tenancy. (con't.)

In such a case, the purchaser owes the entire purchase price upon delivery of the widgets. Similarly, in the lease example, when B becomes entitled to occupy the premises, he owes A the whole of the rent.

In *C.I.B.C.* v. *Tuckerr*,[19] however, the court found that rent under a lease that became due after the assignment of a cross demand could not be set-off against the cross demand. The court became confused over the distinction to be drawn over an accumulating obligation, and one which has accumulated, but the satisfaction of which is deferred to a future time.

(ii) Lease of Personal Property

The same position applies when the lease is of personal rather than real property. A leases a car from B for 2 years. The lease calls for the payment of $5000 in equal monthly installments. Again, many people would look upon this as a situation where A gradually performs his obligations (perhaps month by month) and B's obligation to pay accumulates as A performs. In fact A performs in full when the car is provided to B under the lease.

In *Business Computers* v. *Anglo-African Leasing*,[20] however, the court held that future payments under a lease could not be set-off. Again, the court seems to have been confused over the distinction between an obligation which gradually accumulates, and one which has accumulated, but the payment of which is deferred to a future time. The question that must be answered is "is it owed", not "is it payable."

It is interesting to observe that, in *Anglo-African*, the court felt that had the defendant exercised his right to accelerate the payments under the lease on the plaintiff's breach, then the whole of the rent would have been capable of being set-off. A person may not accelerate the performance of obligations he is not owed.[21] Clearly, if the defendant was entitled to accelerate the payments, it was because the contractual provisions relating to the deferral of payments owed to the defendant were brought to an end.

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18. (con't.) Monetary obligations under a lease are *debitum in praesenti, solvendum in futuro*. In *Tuckerr Industries Ltd., supra*, n. 15, however the British Columbia Court of Appeal did not consider the exception for *debitum in praesenti, solvendum in futuro*.

[19] *Supra*, n. 15.

[20] *Supra*, n. 12.

[21] *Re Emerald Christmas Tree Co. and Boel & Sons Enterprises Ltd.*, (1979) 105 D.L.R. (3d) 75 (B.C.C.A.).

(d) Reform

Obligations that are binding but not payable until some future time should be treated by the law of set-off the same as obligations that are currently payable. The confusion resulting from cases like *Holt* v. *Telford*, *Tuckerr* and *Anglo-African*, and the basic injustice of not permitting a set-off in these circumstances, must be remedied by legislation.

It was tentatively proposed in the Working Paper[22] that it should be possible to set-off a cross demand which is capable of being ascertained before an assignment is completed but which does not fall, accrue due or become payable until a later date. We are convinced that this position is correct, and should be endorsed by legislation.

E. Inter-related Cross Demands

The principle that a cross demand maturing after an assignment may be set-off if it arises from the same or a related transaction was first endorsed by the Privy Council in *Government of Newfoundland* v. *Newfoundland Railway Co.*[23]

1. THE SUPREME COURT OF CANADA

In *Holt* v. *Telford*, it was found that the transactions were sufficiently inter-related to permit a set-off:[24]

> ...the debts can be set-off only if the Telfords can demonstrate that they arise out of the same contract or closely interrelated contracts. In my view, the Telfords have succeeded in demonstrating this. In essence, what happened here was that the Telfords and Canadian Stanley "swapped" parcels of land. The Telfords bought land from Canadian Stanley and gave a mortgage to Canadian Stanley but they also sold land to, and received a mortgage from, Canadian Stanley. The mortgages were entered into on the same date. The purchase price for both parcels was the same, namely $265,000. Except for the January 31, 1981 payment the payments under the two mortgages were on the same dates and for the same amounts. It is these two latter payments under the Canadian Stanley mortgage and the Telford mortgage that the Telfords seek to set-off against each other. Because the Telford mortgage and the Canadian Stanley mortgage are part of the land exchange deal, being part of the consideration for the reciprocal transfers, they are, in my view, closely connected and meet the requirements for an equitable set-off. They were made with reference

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[22] *Working Paper on Set-Off* (WP No. 54), Chapter V, "Unmatured Claims."

[23] (1888) 13 App. Cas. 199 (P.C.).

[24] *Supra*, n. 1, 215 (S.C.R.), 401-2 (W.W.R.).

to one another. It would be unfair to enforce only one side of the land exchange agreement.

The approach adopted by the Supreme Court of Canada on this issue possibly represents a significant easing of the tests applied by the courts to determine whether demands arise from related transactions.[25] The law before *Holt* v. *Telford* is not particularly easy to summarise.

2. EARLIER AUTHORITY

Earlier cases formulated a number of tests to determine whether equity would permit a cross demand to be set-off. These are:

(a) whether the claims are from the same or related transactions

(b) whether the claim impeaches the principal claim

(c) whether there is some equitable reason for equity to intervene.

Does anything turn on which formulation is adopted? The better view is probably that each is saying essentially the same thing. In practice, however, courts apply a variety of standards to determine whether an equitable set-off exists. The reason for these different standards may be due to confusion resulting from the number of formulations used to express what must be a single test. For example, a review of some cases dealing with the test expressed in terms of related transactions reveals the following distinctions:

(a) Equitable set-off is restricted to cross-actions which arise out of the same subject matter as the plaintiff's action.[26]

(b) *Government of Newfoundland* v. *Newfoundland Railway Co.*,[27] endorsed the same or related transaction test for claims arising after notice of an assignment, but it was observed:[28]

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[25] Certainly, it is difficult to reconcile the test adopted in *Holt* v. *Telford* and the result, with that in *Atlantic Lines & Navigation Co. Inc.* v. *The Ship "Didymi"*, (1987) 39 D.L.R. (4th) 399 (F.C.A.). The court refused to permit set-off of claims arising from the same transaction on the ground that the defendant's cross demand did not "impeach" the plaintiff's case. The "*Didymi*" was, however, a charter-party case.

[26] *Stooke* v. *Taylor*, (1880) 5 Q.B.D. 569 (C.A.); *Pos* v. *Pos* (1985), 61 B.C.L.R. 388 (S.C.).

[27] *Supra*, n. 23. *Government of Newfoundland* v. *Newfoundland Ry. Co.* involved competing claims arising from related transactions. The government contracted with the company to build a railway. By a collateral agreement, the government agreed to provide land grants as the work progressed, and subsidies at various intervals. The railway company assigned the benefits of these subsidies to a third party. The court found that the liability to pay the subsidies was independent of progress on the work. (con't.)

> There is no universal rule that claims arising out of the same contract may be set against one another in all circumstances.

(c) In *C.I.B.C.* v. *Tuckerr Industries Inc.*,[29] the test was stated in terms of relationships: one claim arose from a client/accountant relationship; the other claim arose from a landlord/tenant relationship. Since these were unrelated relationships there was no right of equitable set-off.

(d) In *Aboussafy* v. *Abacus Cities Ltd.*,[30] each contract was said to be "unrelated to the other in the sense that no term of one is conditional upon the performance of any term in the other." It was, however, conceded by counsel "that the existence of the claim and cross-claim were unrelated, *i.e.*, pure coincidence."[31]

In *Holt* v. *Telford* the court did not look for "an equity to intervene," nor was it necessary to establish that the transactions were related in the sense that performance of one was conditional upon performance of the other.

3. In Terms Of Policy

It has always been necessary to satisfy one form or another of the related transaction test in order to support equitable set-off. If the transactions are sufficiently related, set-off is available. Moreover, if equitable set-off is available, then cross demands maturing after an assignment of a principal demand may be set-off.

It would appear that there has also always been some doubt concerning the relationship or degree of connection nec-

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27. (con't.) Nevertheless, because of the fundamental relationship between the two contracts, the court ruled that a set-off of the damages for breach of the building contract should be permitted against the amount of the subsidies due.

[28] *Ibid.*, 212.

[29] *Supra*, n. 15.

[30] (1981) 124 D.L.R. (3d) 150, 153 (Alta. C.A.). In *Aboussafy* the plaintiff's claim arose from the third of three related contracts entered into over several years. The first contract involved a sale of land. The second involved a building contract for the development of the land. The third involved management of the building once completed. Only a claim for damages arising from the breach of the third contract could be pleaded as a set-off. Unliquidated claims arising from breaches of the earlier contracts could not be set-off against claims on the management contract, even though the contracts were related to some extent.

[31] *Ibid.*, 155. This approach seems also to have been adopted in *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14 (B.C.C.A.) although in that case a fundamental connection was found. *See* further *supra*, Chapter II, n. 11. This approach, however, was rejected in *Colonial Bank* v. *European Grain Shipping Ltd.*, [1988] 3 W.L.R. 60, 76 (C.A.).

essary to support equitable set-off.[32] While there has to be some reason for equity's intervention, the principles applied to decide when equity should intervene have never been decided with anything like precision.

In our view, the position adopted by the Supreme Court of Canada is sensible. Parties enter into business arrangements which can be recorded and carried out in a variety of ways. In *Holt* v. *Telford*, for example, a single legal document could have recorded the conveyances of the properties against which the mortgages were registered. The substance of the transaction does not alter because the parties, or their legal advisors, choose to record the transaction in several different legal documents.

4. REFORM

The form of the transaction should not alter the principles that apply to determine what kinds of cross demands may be set-off. It was tentatively proposed in the Working Paper that it should be possible to set-off a future cross demand which arises from the same, or a related, transaction as the principal demand. We remain convinced that this position is correct.

F. Other Kinds of Cross Demands

1. INTRODUCTION

The nature of the amendments to the law that we contemplate would permit the set-off of any claim that arises, and is payable, *before* an assignment takes place. The current law, however, recognizes set-off in two situations where a cross demand does not become fully enforceable or complete until *after* an assignment of a principal demand takes place. These are:

(i) when a debt is owed before an assignment, but not due until a later time; and

(ii) when a cross demand derives from a transaction interrelated to the transaction from which the principal demand arises.

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[32] *See supra*, Chapter III n. 7.

We have already concluded that both of these features of the current law should be retained.

In the balance of this section, the issue addressed is whether the set-off of other categories of cross demands, which mature at some future time, should be permitted.

2. CATEGORIES OF MATURING CROSS DEMANDS

In the Working Paper that preceded this Report, the various categories of claims that would be enforceable at some future time were categorized as follows:[33]

(i) a binding obligation subject to no condition other than, perhaps, the effluxion of time, for example, a debt obligation not due until a particular date.

(ii) an obligation subject to a condition, other than the effluxion of time, that must be satisfied before it is binding. For example, A guarantees a loan made to B. A's obligations as guarantor will arise only if B defaults.

(iii) an inchoate obligation which depends upon an event that may or may not occur at some future time. For example, A is slandered by B. No rights arise until A suffers damages.[34]

(iv) an obligation all the elements of which do not arise until some future time.

We have already concluded that the first category of obligations (which fall into the exception for *debitum in praesenti, solvendum in futuro*) should be capable of being set-off. In the other three categories, the availability of set-off depends upon whether the cross demand satisfies the related transaction test.

We think there are sound reasons for adopting a broader approach. These reasons are discussed below.

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[33] *Supra*, n. 22.

[34] When considering incomplete obligations, it is useful to contrast the consequences of a breach of duty of care depending on whether the duty is imposed by contract or the general law. Breach of a duty of care imposed by the general law is a tort. A person who has been injured by the negligence of another has no cause of action until he suffers damages. In contrast, a person who has been injured by another in breach of a contractual duty of care has a cause of action even though he does not suffer damages until some future time.

3. RELATED AND UNRELATED TRANSACTIONS

The exception recognized by the law which allows the set-off of cross demands arising from related transactions makes some sense. Certainly, where cross obligations arise from the *same* transaction, it is difficult to justify separating the rights of plaintiff and defendant so that each must pursue a remedy in a separate proceeding. It is relatively clear, and generally agreed, that in this situation set-off is appropriate.

It is a small step from this to recognizing that set-off is equally appropriate where the cross obligations arise not from the same transaction, but from *related* transactions.

It may be suggested, however, that the related transaction test is only useful within certain limits but is not, and ought not to be, the whole story. There are degrees of relatedness. Virtually every commercial dealing between two parties is related to every other commercial dealing between them, as part of the course of their business.

One cannot always be sure, however, where the courts will come down when the issue of relatedness arises. For example, a person may provide accounting services to his landlord. Neither landlord nor tenant is likely to overlook the fact that each has claims against the other, although the practice is often not to set-off the claims as they arise. Customarily, each party keeps his separate business accounts and bills are paid in the usual course.[35] The law quite sensibly assumes, however, that parties rely on rights of set-off unless, by agreement, they expressly waive them.[36] It is only when there is an assignment that principles antithetical to ordinary business practice are applied.

There is, consequently, some merit in adopting an approach which allows the set-off of claims arising from the mutual dealings of the parties, whenever these claims arise. We would not, however, go quite this far. Permitting the set-off of a claim that arises wholly after an assignment (without the protection offered by the related transaction test) would have the potential to prejudice gravely the successor in interest.[37] He would be unable to assess the value of the assigned claim with any accuracy, nor protect himself by, for example, inquiring as to the state of accounts between the assignor and the obligor before accepting the assignment.

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[35] *E.g.*:
January 1 - A, a supplier of raw materials, purchases equipment for $10,000 from B on credit. A expects to satisfy this debt through future deliveries of raw materials to B.
February 1 - B assigns A's debt to D and notice is given to A.
March 1 - A supplies materials to B worth $2,000.
April 1 - B becomes insolvent.
May 1 - D demands payment of the $10,000 from A.
This fact pattern would not satisfy the related transaction test, at least in terms of decided cases, but it is not altogether clear that a court would refuse a set-off. Perhaps B understood that A intended to satisfy his debt by supplying materials to him.

[36] *Supra*, n. 4; *see also supra*, Chapter II, n. 17; Chapter IV, n. 24.

4. TIMING

While we recognize the need for some limits on the kinds of cross demands that may be set-off, it is our view that the current law adopts too restrictive an approach in this regard. Three examples are useful at this point to illustrate our concerns:

Example 1:

Jan. 1 -	A owes B $1000.
Feb. 1 -	B borrows $1000 from C. A guarantees the loan.
Mar. 1 -	B assigns A's debt to D and notice is given to A.
Apr. 1 -	B defaults on the loan from C. A pays C $1000. A now has a right of indemnity from B.
June 1 -	D demands A pay the assigned loan from B.

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[37] *E.g.*:

January 1 -	A borrows $10,000 from B.
February 1 -	B assigns A's debt to D and notice is given to A.
March 1 -	B injures A in an automobile accident.
April 1 -	B becomes insolvent.
May 1 -	D demands payment of the $10,000 from A.

Example 2:

Jan. 1 - A owes B $1000.

Feb. 1 - B advises A to enter into a binding agreement to buy certain shares at a specified price on May 1. (The advice is not given as part of a contractual arrangement.) A relies on the advice and enters into the agreement.

Mar. 1 - B assigns A's debt to D and notice is given to A.

Apr. 1 - It is discovered that B's investment advice was given negligently. A, however, will not have a cause of action against B unless he actually suffers loss. Whether A will suffer a loss and what it will be cannot be determined until the shares are transferred to him.

May 1 - A's loss is quantified at $1000.

June 1 - C demands payment of the $1000 from A.

Example 3:

The facts are the same as in Example 2, except B's advice to A is given pursuant to a contract.

In the first two examples some, but not all, of the facts and circumstances necessary to constitute the cause of action which forms the basis of the cross demand are in existence before the assignment. In each of these cases, consequently, at the time the assignment is made there may be some doubt whether the cross demand will ever materialize or, if it does, whether it will be of any significant amount. After the assignment, however, the additional facts necessary to complete the cause of action come into existence. In example 3, all of the facts and circumstances necessary to constitute the cause of action which forms the basis of A's cross demand are in existence before the assignment. The amount of A's damages, however, will not be known until after the assignment.

The order in which a cross demand matures and an assignment takes place is something over which the obligor has no control. The assignor and his successor in interest, on the other hand, may often affect the order. It is open to the assignor and successor in interest to arrange matters so that the assignment takes place before the cross demand matures, thereby avoiding the operation of set-off.

Example 1 (the guarantee example) demonstrates the injustice that may arise from limiting rights of set-off by reference to the time when a cross demand arises. If B anticipated default on the guaranteed loan, the assignment borders on a fraudulent conveyance. The law in other contexts prevents a person from alienating property or rights in an effort to impede the enforcement of another's claim against him. Arguably, the law of set-off, to be consistent, should be framed in such a way as to limit a person's ability to restrict or extinguish unilaterally another's rights.

An obligation may be incomplete in the sense that not all elements necessary to *constitute* a cause of action have been satisfied. On the other hand, a claim may be considered to be incomplete solely because not all elements necessary to assess its *value* have occurred. At one point, the Commission considered endorsing an approach which would permit the set-off of obligations that were binding, although not yet quantifiable. A comparison of examples 2 and 3, however, suggests that it would be an inappropriate response to recognize a distinction on this basis. For purely historical reasons, the principles of contract and tort differ in a number of technical respects. A breach of contract is actionable as soon as the breach occurs whether or not damages have yet been suffered. Negligence, on the other hand, does not become actionable until damages have been suffered. Different results shouldn't follow depending on the source of the obligation that is breached. The tendency of the modern law is, whenever possible, to parallel the principles of contract and of tort.

5. INSOLVENCY

Our discussion so far has centred on situations involving consensual assignments. If we alter the facts slightly, so that a successor in interest becomes involved by reason of the assignor's insolvency (by receivership or bankruptcy) the prejudice to the obligor that arises because rights of set-off are unavailable becomes even more clear. In these circumstances, the assignor's insolvency often causes the various cross obligations to arise or become due. The order in which obligations arise may be accidental, or the result of manipulation by the parties. In either case, it is difficult to raise a convincing argument for preferring the successor in interest over the obligor by limiting rights of set-off.

Jan. 1 - A owes B $1000.

Feb. 1 - B borrows $1000 from C. A guarantees the loan.

Mar. 1 - B defaults on the loan from C.

Apr. 1 - B becomes bankrupt. D is B's trustee in bankruptcy. D becomes entitled to recover the debt A owes B.

May 1 - C requests A to honour the guarantee. A pays C $1000. A now has a right of indemnity from B.

June 1 - D demands A pay the assigned loan from B.

The sequence of B's bankruptcy, the default of the loan from C and the demand under the guarantee may have occurred accidentally, or been decided by one of B's creditors. In the above example, A has no right of set-off. If B defaulted on the loan from C and A honoured the guarantee before the assignment in bankruptcy, however, A would have a right of set-off. It is not altogether clear that it is appropriate to determine rights of set-off by reference to accidents of timing. Moreover, in many cases (as in the example given above) all of the facts necessary to assess the defendant's right or claim will come into being either shortly after the assignment or, in any event, by the time the obligor is called upon to answer the principal demand.

It would appear that the defendant should be able to rely upon rights of set-off in these circumstances at least up until an action is commenced to enforce the principal demand. Should the process stop there? Or should it continue even where not all of the facts necessary to complete a cause of action, or to assess the value of the cross demand with certainty, have materialized at the time the defendant is called upon to answer the principal demand?

6. VALUATION OF CONTINGENT CROSS DEMANDS

One argument against allowing the set-off of demands which have not fully matured is that their valuation adds a dimension of complexity to the proceedings. It might well be anticipated that difficulties will arise valuing a claim before it is fully enforceable or complete. Where a cross demand depends upon a contingency, for example, the contingency may or may not occur. Valuation becomes very much a matter of guesswork.

Experience demonstrates that this argument is more apparent than real. In other areas of the law, such as the awarding of damages for personal injuries, the courts must make valuations involving the assessment of various contingencies that may or may not arise over the course of decades. In the context of set-off, it will often be the case that by the time the successor in interest attempts to enforce his demand, what was once a contingency will have been satisfied and no problems of valuation will arise. Even if not all elements of the cross demand have materialized at that time, it is still probable that the process of valuation will not be complex. Where a successor in interest becomes involved by reason of the assignor's insolvency, for example, it is pretty clear that an obligor who has not yet been required to honour a guarantee will have to do so eventually. Assessing the value of a "contingent" obligation in these circumstances would appear to be fairly straightforward.

Where evidence suggests that the occurrence of a contingency upon which liability depends is remote, it is open to the court to place a nominal value on a cross demand. In our view, problems of assessing maturing cross demands do not admit of sufficient practical difficulty to justify preventing them from being set-off.

7. SUMMARY

There are a number of reasons for allowing maturing cross demands to be set-off in a broader range of circumstances than are currently permitted.

The present law appears to be based upon the apparent lack of any justification for allowing the set-off of unrelated demands. However, looking only to whether transactions are related is not, in itself, a demonstrably just yardstick for determining rights of set-off. Other tests must be adopted to aid in the determination of whether particular cross demands may be set-off.

Whether cross demands are related is often a reflection of the manner in which the parties conducted their business relationship. The form taken by a continuing course of business transactions is not necessarily conclusive as to whether they are related, so that set-off is available, or unrelated, so that it is not. Furthermore, it may be argued that any cross demands arising from the mutual course of dealings of parties are related. English bankruptcy legislation has proceeded on this basis for the past 260 odd years. It is a position, consequently, which may be defended with some conviction.

Whether set-off is available is often determined by accidents of timing. In the guarantee example, if A becomes liable under the guarantee before the assignment takes place, he may set-off against his debt to B a right of indemnity (in the amount of his liability under the guarantee). Because the assignment occurs first, however, even if only by a matter of minutes, rights of set-off are not permitted. A distinction of this nature is not altogether convincing, particularly when the law permits the assignor and successor in interest (or a creditor claiming through him) to control when these various events take place. Moreover, in many cases insolvency is the cause of the assignment and this event is linked to, or brings about, the contingency upon which the cross demand depends. It is not satisfying to determine rights in this context by the order in which certain events occur.

Finally, these limitations on rights of set-off appear to reflect a long rejected bias of the law against assessing damages. In fact, the courts regularly assess the value of contingent claims without apparent difficulty, and there is no reason why they cannot do so in the context of set-off.

In our view, consequently, the law should allow the set-off of a cross demand where some (but not all) elements of it are in existence at the time a successor in interest becomes entitled to proceed on a principal demand.

CHAPTER VI MISCELLANEOUS ISSUES

A. Introduction

A number of issues relating to set-off have not yet been addressed in this Report. These include various procedural issues as well as points of detail that may arise where a cross demand is successfully raised to diminish or extinguish a principal demand. These issues are addressed in this Chapter.

1. PROCEDURE FOR RAISING A SET-OFF

(a) As a Counterclaim

Earlier, we concluded that counterclaim, not set-off, should be the procedure for raising a cross demand. Legislation must, however, clarify how a cross demand owed by an assignor may be raised against a successor in interest.

(b) Procedural Issues

Revising the law to provide that cross demands may only be raised by counterclaim enhances the law in a number of respects. It frees the current law from the confusion that surrounds the ancient principles governing rights of set-off. Moreover, employing the existing concept of counterclaim to bring a cross demand formerly brought as a set-off resolves all of the various procedural issues that may arise. For example, one correspondent suggested that legislation should provide that, when an obligor raises a cross demand against an assignee, he may join the assignor who is also answerable for it. Rule 21(8) however provides:

> Where a defendant sets up a counterclaim which raises questions between himself and the plaintiff along with any other person, the defendant may join that person as a party against whom the counterclaim is made.

There is, consequently, no need to provide an additional mechanism for joining the person originally answerable on a cross demand raised against an assignor.

(c) Contrived Claims

One submission on the Working Paper feared that broader rights of set-off would lead to abuses. Debtors might raise contrived claims. This comment seems to overlook that currently debtors sometimes raise contrived cross demands by counterclaim. Adopting the revisions to the current law that we recommend in no way impairs the court's ability to control contrived claims. Rule 19(24) provides:

> At any stage of a proceeding the court may order to be struck out or amended the whole or any part of an endorsement, pleading, petition or other document on the ground that
>
> (a) it discloses no reasonable claim or defence as the case may be, or
>
> (b) it is unnecessary, scandalous, frivolous or vexatious, or
>
> (c) it may prejudice, embarrass or delay the fair trial or hearing or the proceeding, or
>
> (d) it is otherwise an abuse of the process of the court,
>
> and may grant judgment or order the proceeding to be stayed or dismissed and may order the costs of the application to be paid as between solicitor and client.

Moreover, the Rules provide that a court may order that a counterclaim be heard separately.[1] It would not seem to be necessary to provide a court with additional powers to control frivolous, inappropriate or contrived claims from being raised to the prejudice of a plaintiff.

(d) Amendments to the Rules of Court

Two rules in the British Columbia *Rules of Court* refer to rights of set-off. These are Rules 19(13) and Rule 21(15). In accordance with our view that rights of set-off should be revised, these rules should be amended.

(i) Rule 19(13)

Rule 19(13) provides:

> A defendant in an action may set off or set up by way of counterclaim any right or claim, whether the set-off or counterclaim is for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

It is derived from Rule 20 of the *Rules of Court* promulgated with the *Judicature Act, 1873*, which provided, in part, as follows:

> 20. A defendant may set off, or set up, by way of counter-claim against the claims of the plaintiff, any right or claim, whether such set-off or counter-claim sound in damages or not, and such set-off or counter-claim shall have the same effect as a statement of claim in a cross action, so as to enable the Court

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[1] Rules 21(13) and 5(7).

> to pronounce a final judgment in the same action, both on the original and on the cross claim...

The proper interpretation of Rule 19(13) and its predecessors has been addressed by English and British Columbia courts on many occasions. The issue is whether the rule provides that any matter may be set-off by a defendant, or whether it applies only to those matters capable of set-off before 1873 so that all other cross demands must be the subject of a counterclaim. Authority tends to favour the latter construction.

The meaning of Rule 20 is far from plain. It used the concepts of set-off and counterclaim in contradistinction. The significant point, however, would appear to be an intention that set-off differ in no material way from pursuing a cross demand by counterclaim.[2] The rule provided that a set-off is made by way of counterclaim, and has the same effect as a cross action. An inference that may be drawn is that the law of set-off was to be submerged in rights of counterclaim.

Removing the punctuation in Rule 19(13) allows the rule to be interpreted as acknowledging separate proceedings for bringing cross demands. A set-off is brought as a defence. A counterclaim is brought by counterclaim. This approach has kept intact the ancient and confused law of set-off. Our conclusions respecting the need and approach for reform essentially adopt the course mapped in 1873.

The revisions to Rule 19(13) we recommend consist of the deletions marked by brackets:

> 19(13) A defendant in an action may [set off or] set up by way of counterclaim any right or claim, whether [the set-off or counterclaim is] for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

Rule 19(13) has been altered by removing the reference to set-off. When this amendment is made, the *Rules of Court* will no longer recognize set-off as a means of raising a cross demand.

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[2] *See, e.g., McDonnell & East Ltd.* v. *McGregor*, [1936] 56 C.L.R. 50, 58 (H.C.A.).

(ii) Rule 21(15)

(1) Revisions to the Rule

The amendments to Rule 21(15) we recommend consist of the deletions marked by brackets. Additions are underlined:

> 21(15) Where a [set-off or] counterclaim [establishes a defence to] extinguishes the plaintiff's claim, the court may give judgment for the defendant for any balance in his favour or for such other relief as the court thinks just.

The amendments to Rule 21(15) involve removing the reference to set-off. Where a defendant successfully raises a cross demand that exceeds the plaintiff's claim, the court is authorized to give a judgment in the defendant's favour for the excess. This will not always be appropriate. Where the cross demand is raised against an assignee, for example, it may only be relied upon to diminish or extinguish the assignee's claim. That result is contemplated by Rule 21(15).

(2) Should Rule 21(15) Apply to Successors in Interest?

Focusing on the position of an assignee is misleading. As was observed earlier, a third party will become entitled to enforce an obligation in a number of circumstances. For example, his entitlement may vest by reason of the insolvency or death of the party originally entitled to enforce the obligation. In the Working Paper, an attempt was made to distinguish between the various situations where a third party is entitled to enforce an obligation by characterizing the assignment as either voluntary, in the sense that it was the result of agreement, or involuntary, in the sense that it was caused by the insolvency or death of the assignor. Some of our correspondents felt that the terminology used was not particularly helpful.

It is probably more apt to explain the distinction in terms of persons who assert some, but not all, rights of an original party and persons who assert all rights of an original party. Alternatively, it may be expressed in terms of how much of the original party's estate is concerned. An assignee is involved in only a portion of the original party's estate, the assigned chose in action. Other kinds of successors in interest (such as trustees in bankruptcy, receivers and personal representatives) represent all, or most, of the original party's estate.

Where the successor in interest represents only a portion of the original party's estate, the assigned chose in action, then it is only appropriate to apply a cross demand to extinguish or diminish the assignee's claim. Where the successor in interest represents a portion of the original party's estate that is greater than the claim he pursues, then it is appropriate to give judgment for a cross demand that exceeds the claim, at least to the extent of the estate represented by the successor in interest. The court has jurisdiction to do this under Rule 21(15).

2. LIMITATIONS

In one submission received on the Working Paper, it was observed that under the *Limitation Act*[3] an important distinction was drawn between rights of set-off and counterclaim. Section 4 of the *Limitation Act* provides:

> **4.** (1) Where an action to which this or any other Act applies has been commenced, the lapse of time limited for bringing an action is no bar to
>
> (a) proceedings by counterclaim, including the adding of a new party as a defendant by counterclaim;
> (b) third party proceedings;
> (c) claims by way of set off; or
> (d) adding or substituting of a new party as plaintiff or defendant,
>
> under any applicable law, with respect to any claims relating to or connected with the subject matter of the original action.

Section 9 of the Act provides:

> **9.** (1) On the expiration of a limitation period fixed by this Act for a cause of action to recover any debt, damages or other money, or for an accounting in respect of any matter, the right and title of the person formerly having the cause of action and of a person claiming through him in respect of that matter is, as against the person against whom the cause of action formerly lay and as against his successors, extinguished.

A defendant cannot raise an unrelated cross demand that is barred by the expiration of a limitation period. The problem is that the common law applied different principles to set-off and to counterclaim in determining whether a claim had been asserted within a limitation period. A set-off is deemed to be asserted when the plaintiff's writ is issued. A counterclaim is made when it is pleaded.[4]

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[3] R.S.B.C. 1979, c. 236.

If legislation is to provide that all cross demands are to be raised by counterclaim, this anomaly is resolved. Nevertheless, for greater certainty, legislation might provide that issues relating to the assertion of cross demands shall be resolved by the law governing counterclaim.

3. RIGHTS OF SUBROGATION

It was mentioned earlier that a third party will become entitled to enforce an obligation in a number of circumstances. Common examples are assignment, receivership and bankruptcy.

A third party may also become entitled to enforce an obligation by subrogation. For example, B is insured by C. A injures B in an automobile accident. C pays B's claim. C is now subrogated to the claim B had against A. C may sue A for B's losses. A, however, is entitled to raise any defence or cross demand against C that he could have raised had B brought the action:[5]

> Where an insurer exercises a right of subrogation and pursues a third party in the name of its insured, the third party as defendant in the action may raise any defence that was open to it as if the action had been brought by the insured.

Whether rights of set-off are available against an insurer subrogated to the insured's claim was considered in *Best Buy Carpets Ltd.* v. *281856 B.C. Ltd.*[6] It was held that, while subrogation is distinct from assignment, the insurer was in no better position that the insured. The defendant, consequently, was entitled to raise a cross demand, owed by the party originally entitled to bring the action, to diminish or extinguish the insurer's claim:[7]

> In my view, if the right is an equitable right and if the insurer pursues the right subject to any defences available to the third party, any equitable defence available against the insured is available against his insurer.

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[4] *Report on Limitations* (L.R.C. 15, 1974) 83.

[5] *Best Buy Carpets Ltd.* v. *281856 B.C. Ltd.*, [1987] B.C.D. Civ. 1941-01 (S.C.); *Finlay* v. *Mexican Investment Corp.*, [1897] 1 Q.B. 517.

[6] *Ibid.*; *contra Lewenza* v. *Ruszczak*, [1960] O.W.N. 40 (C.A.).

[7] *Ibid.*

For greater certainty, legislation amending the law of set-off should specifically apply to third parties who acquire rights by subrogation.

4. INDEMNITY

When a cross demand is successfully raised against a successor in interest, the value of his claim is diminished. He has been deprived of part of the benefit of his bargain with the assignor. Moreover, the assignor has benefited by the set-off. He has been relieved of that liability. A successor in interest, therefore, should be able to look to the assignor for compensation. A problem, however, arises in determining an appropriate measure of compensation. In the Working Paper that preceded this Report, it was said:[8]

> In many cases, the consideration received for an assigned claim is based on the value of the claim, discounted to take into account a variety of factors. One factor will be the likelihood that the claim will not be collected. For example, B owes A $500. A assigns that claim to C for $200. It is doubtful that the claim will be collected, so A is willing to accept a small amount for the assignment, while C is willing to take the risk that it will be uncollectable. If B successfully sets-off a cross-demand [based on rights against A] that extinguishes the assigned claim, should C be entitled to an indemnity for the value of the assigned claim ($500) or for the value of the consideration he gave for it ($200)? These concerns are usually addressed by agreement between the assignee and the assignor. It is our tentative view, however, that in the absence of agreement, the assignee should be entitled to an indemnity from the assignor to the extent that the assignor is relieved from liability by the set-off of a cross-demand.

In effect, the consideration given for the assigned claim does not figure in determining the amount of the indemnity. In the example, C should be entitled to an indemnity for $500.

Comment we received on this tentative proposal was divided. On one side of the spectrum, it was suggested that to provide for an indemnity in these circumstances was inappropriate. The possibility that the debt would not be collectable was taken into account when it was assigned, and determined the price for the assignment. Legislation should not provide for an indemnity in these circumstances, although the parties should be free to agree between themselves on this issue.

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[8] *Working Paper on Set-Off* (WP No. 54, 1987) 44.

There will be many cases, however, where an assignee will not be aware of the existence of a set-off. Calculating the consideration for the assignment with a view to the possibility that the debt may not be collected cannot be an exact process. Perhaps the assignor is aware of the existence of the cross demand, and the assignee is not. Why should the assignor benefit, if the cross demand is raised successfully and extinguishes the assigned debt?

On the other side of the spectrum, it was suggested that there was no need for an indemnity since the law already provides, in the absence of an agreement to the contrary, that the assignee may proceed against the assignor to recover the amount set-off. One possible means of doing so is by subrogation.

Even if such rights currently exist, there will be some doubt as to their operation if legislation clarifying rights of set-off is enacted. We have concluded that the position identified in the Working Paper should be adopted. It is desirable to provide specifically for a right of indemnity that is calculated by the benefit received by the assignor when the claim of a successor in interest is diminished by a set-off.

A right of indemnity, however, will not protect all successors in interest. Where the successor in interest becomes entitled to proceed by reason of the receivership or bankruptcy of the original person entitled to enforce the claim, there is no possibility of recovering on the indemnity. In practical terms, only when the assignor remains solvent will the successor in interest recover anything.

5. GARNISHMENT

Suppose B is the defendant in proceedings commenced by C and A owes B a sum of money. C may be able to have A pay the money he owes into court instead of to B. This is called "garnishment." The person against whom a garnishing order is made is called a "garnishee." The person who applies for the garnishing order is called a "garnishor."

The amount the garnishee must pay into court may be affected by rights of set-off. In the previous example, suppose that A is owed money by B. The amount A would have to pay into court is determined by setting off the amount he is owed by B.[9] The law seems to rest upon the position that a person who issues a garnishing order should be able to recover from the garnishee no more than "the judgment debtor could honestly give him."[10] In other words, the law ensures that the garnishee is in no worse position than if he had been sued for his debt by the judgment debtor.[11]

Part I of the *Court Order Enforcement Act*[12] governs garnishment in British Columbia, but other statutes provide analogous procedures.[13] It would appear that rights of set-off may be raised by a person who is served under other legislation with process similar to garnishment.[14]

In our view, the current law, which permits a garnishee to resist a garnishing order by asserting a set-off, rests upon sound policy. Legislation revising rights of set-off should ensure that a person issuing a garnishing order does not occupy a better position than the person originally owed the debt.

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[9] *Galipeau Musique Inc.* v. *Heckbert and Canadian Imperial Bank of Commerce*, (1979) 28 N.B.R. (2d) 163, 63 A.P.R. 163 (Co. Ct.); *Ledingham Construction Ltd.* v. *Cranbrook Golf & Country Club and Royal Bank of Canada*, (Unreported B.C.S.C. decision) Van. Reg. No. 73/20184; *Gandy & Allison Ltd.* v. *Erectors & Constructors Ltd.*, (1963) 43 D.L.R. (2d) 461 (N.B. Co. Ct.); *Centennial Packers Ltd.* v. *G.C.L. Hotel Ltd.*, [1988] B.C.D. Civ. 1724-02 (Co. Ct.). If the cross demand owed A cannot be set-off, however, it will not be taken into account when determining the amount that must be paid into court: *S/S Steamship Co.* v. *Eastern Carribean Container Line S.A.*, [1986] 2 F.C. 27, 26 D.L.R. (4th) 472 (F.C.A.); *Ross Gibson Industries Ltd.* v. *Columbia Roofers Ltd.*, [1987] B.C.D. Civ. 1724-03 (S.C.).

[10] *Wilson* v. *Fleming*, (1901) 1 O.L.R. 599 (Div. Ct.); *Gandy & Allison Ltd.*, *ibid.*

[11] It is interesting to note, however, that a garnishee may not set off a cross demand he has against the garnishor: *Sampson* v. *Seaton and Beer Ry. Co.*, (1874) 10 L.R. Q.B. 28, 30 *per* Lush J.

[12] R.S.B.C. 1979, c. 75. That Act provides a mechanism for scrutinizing and adjusting cross demands, in s. 18:

> 18. If the garnishee disputes his liability, a judge, instead of making an order for payment into court or otherwise, may order that any issue or question necessary for determining the liability of the garnishee be tried or determined in any manner in which an issue or question in any action may be tried or determined.

[13] *See, e.g.*, *Employment Standards Act*, S.B.C. 1980, c. 10; *Income Tax Act*, R.S.C. 1970, c. I-5, s. 224.

[14] *See, e.g.*, *Rasmussens' Ltd* v. *Melville Country Club*, [1977] 4 W.W.R. 382 (Sask. D.C.).

CHAPTER VII DRAFT LEGISLATION

A. Overview of the Legislation

The draft legislation contained in the next section is annotated, but it is useful to provide an overview of it. In keeping with our earlier conclusions, the legislation has the following features:

(i) The fundamental principle adopted is that an assignee proceeding against an obligor should occupy no better position than the assignor;

(ii) Rights of set-off have been replaced with a statutory right of "cross demand." A cross demand is brought by counterclaim;

(iii) The legislation uses the term "successor in interest" instead of assignee. The principles of cross demand are to apply consistently in every situation where a third party becomes entitled to enforce an obligation;

(iv) Any matter which could have been raised between the original parties by counterclaim may be raised against a successor in interest as a cross demand (temporal questions aside);

(v) The manner in which a cross demand will function is defined by the legislation;

(vi) Problems relating to cross demands which are not fully enforceable or complete until after an assignment of a principal demand takes place are resolved.

Various British Columbia statutes and portions of the *Rules of Court* refer to rights of set-off. When legislation patterned after the draft legislation in the next section is enacted, it will no longer be appropriate to rely on set-off as a term of art. Necessary amendments are listed in Appendices A and B to this Report.

The Commission recommends that:

(1) Legislation be enacted, as part of the Law and Equity Act, *that embodies the principles of the draft legislation in Chapter VII of this Report.*

(2) Ancillary amendments to the statutes listed in Appendix A to this Report be made.

(3) Ancillary amendments to the Rules of Court *listed in Appendix B to this Report be made.*

B. Legislation

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

1. The *Law and Equity Act*, R.S.B.C. 1979, c. 224, is amended by adding the following section:

Cross Demands

60. (1) In this section

"cross demand" means any right or claim which may be raised by an obligor to diminish or extinguish an obligation;

The draft legislation redefines rights of set-off. To distinguish statutory rights from current rights of set-off, claims that may be set-off under the draft legislation are called "cross demands."

A cross demand is brought by counterclaim. If the original parties entitled to enforce the cross demands are involved in the litigation, rights of set-off are replaced by rights of counterclaim. See subsection (2) and the recommended amendments to the *Rules of Court* that follow this draft legislation.

Counterclaim is the procedure recognized under the *Rules* by which a defendant raises a cross demand against a plaintiff. It is a separate pleading from a statement of defence. A statement of defence is the pleading in which the defendant raises matters to resist the plaintiff's claim. See also Chapter II.

Subsection (4) provides how a cross demand will function when a successor in interest is involved. It will be used to diminish or extinguish the claim of the successor in interest.

See the definition of "successor in interest."

"obligor" means a person who owes an obligation to another;

Self-explanatory.

"successor in interest" means a person who succeeds to the right of another person to proceed on an obligation, whether by assignment, subrogation, operation of law or otherwise, but does not include a holder in due course of a negotiable instrument;

A "successor in interest" may become entitled to enforce an obligation against an obligor in a number of circumstances, such as an assignment for value, receivership and bankruptcy.

In any situation where a claim is sought to be enforced by someone other than the party originally entitled to do so, the draft legislation governs the manner in which a cross demand may be set-off.

An exception is made for a "holder in due course."

The law governing negotiable instruments is based on the fact that commerce requires a medium of exchange. Different principles concerning cross demands that may be raised to diminish or extinguish a negotiable instrument have been developed. These are unaffected by the draft legislation.

A "holder in due course" is a person who accepts a bill of exchange before it is due, *bona fide* and for value.[1]

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[1] *See* s. 56(1) *Bills of Exchange Act*, R.S.C. 1970, c. B-5; Crawford and Falconbridge, *Banking and Bills of Exchange*, (8th ed., 1986) vol. 2, 1454. Crawford notes that Chalmers coined this phrase to replace the more cumbersome "*bona fide* purchaser for value."

"time of vesting" means the time when the entitlement of the successor in interest to enforce an obligation according to its terms against an obligor vests.

A successor in interest may acquire the right to enforce an obligation in several different ways.

When a claim becomes vested depends on how the right to enforce the obligation was acquired.

For example, if a chose in action is assigned to another, entitlement to enforce the obligation vests when the successor in interest gives notice of the assignment.

When the successor in interest is a receiver, his entitlement vests when he is appointed.

When the successor in interest is a trustee in bankruptcy, his entitlement vests when the receiving order is made.

"Time of vesting" is an important concept. Some claims which arise after the time of vesting may not be set off. See subsection (4).

(2) A cross demand shall be brought by counterclaim notwithstanding that it might, but for this section, have been raised as a set-off.

Currently, a cross demand may be brought by a counterclaim or as a set-off. Under the draft legislation, the only procedure by which a cross demand may be brought is counterclaim.

(3) Where a party raises a cross demand but fails to bring it as a counterclaim as required by subsection (2), it shall be treated as a counterclaim, and

(a) the party may, notwithstanding the expiration of a limitation period, amend his pleadings in accordance with the *Rules of Court* at any stage of the proceedings to bring the cross demand as a counterclaim; and

(b) the court may give such directions or make such orders as may be appropriate in the circumstances.

Changes in the law sometimes create traps for the unwary.

If a person attempts to raise a cross demand as a defence, it may still be brought as a counterclaim.

(4) Where a successor in interest proceeds on an obligation against an obligor, the obligor may raise, to diminish or extinguish the obligation, the present value of any right or claim which could have been raised as a defence against a person formerly entitled to enforce the obligation, including a right or claim

An obligor may set-off against a successor in interest any cross demand or defence that could have been raised against a person originally entitled to enforce the obligation.[2] In some cases, the benefit arising from early payment of a cross demand should be taken into account. This is accommodated by the reference to "the present value of a right or claim."

(a) based on an obligation which was in existence, or a breach of duty which occurred, before the time of vesting although
  (i) it does not fall or accrue due or is not payable,
  (ii) not all of the elements necessary to constitute a cause of action come into existence or are satisfied, or
  (iii) its value depends upon assessing contingencies and other facts which will not materialize

  until after
  (iv) the time of vesting or
  (v) the time the cross demand is raised; or

No distinction is drawn between liquidated and unliquidated cross demands.

A cross demand that is owed at the time of vesting, but not payable until a later time may be set-off. See the definition of "time of vesting."

Cross demands which are not fully enforceable or complete until after the time of vesting, even if they arise from a transaction wholly unrelated to the demand of the successor in interest, may be set-off.

(b) arising from the same transaction, or a transaction related to it, as the obligation on which the successor in interest proceeds.

Any cross demand arising from the same transaction or a related transaction may be set-off, even if it arises wholly after the time of vesting.

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[2] This provision alters the current law in an additional way. Currently, only those equities arising between the obligor and the original assignor may be raised against the assignee enforcing the obligation. Equities attributable to an intermediate party do not attach to the assigned obligation: *See, e.g.*, *In re Milan Tramways Co.*, (1882) 22 Ch. D. 122, (1884) 25 Ch. D. 587 (C.A.); *Banco Central S.A. & Trevelan Navigation Inc.* v. *Lingoss & Falce Ltd. & B.F.I. (The "Raven")*, [1980] 2 Ll.L.R. 266 (Q.B.). Under this provision, equities attributable to an intermediate party may be raised against the assigned obligation.

(5) Where the claim of a successor in interest is diminished or extinguished by a cross demand, he is entitled to an indemnity from a person formerly entitled to enforce the claim, to the extent that that person is benefited by the operation of section (4).

When the claim of a successor in interest is affected by a cross demand, the person he acquired the claim from is benefited.

This section ensures that the successor in interest may proceed against the person from whom he received the claim.

Rights of indemnity, however, will not assist the successor in interest if the person from whom he received his claim is insolvent.

(6) Unless prohibited by an enactment, the right to raise a cross demand may be altered or waived by agreement.

Currently, persons may enter into agreements which affect their rights to raise cross demands to resist an obligation.

(7) Where a person purports to attach an obligation through garnishment or similar process authorized by law, the obligor may raise any cross demand that might have been raised against a successor in interest under subsection (4) to diminish or extinguish the amount attached.

A person served with a garnishing order may currently set off cross demands he is owed by the judgment debtor.

Subsection (7) preserves that position for the purposes of the draft legislation.

(8) Where a person makes a deduction from an obligation he owes, nothing in this section shall affect the determination of whether additional rights or obligations are enforceable against that person.

The current law of set off assists in determining whether a party can deduct obligations he is owed from obligations he owes without entitling another party to enforce additional rights. For example, failure to make a payment may be a breach of an agreement and entitle the other party to bring the agreement to an end. Where a person has a right of set-off, perhaps his failure to make a payment should not have that consequence.

In order to help answer questions like these, this aspect of the law of set off should be retained.

(9) Any issue which is not addressed by this section regarding a cross demand, whether the cross demand consists of a defence, set-off, plea of abatement or counterclaim, shall be resolved by the law governing counterclaim.

This section is included to ensure that no distinctions between set-off and counterclaim will remain after the legislation is enacted.

The draft legislation is intended to be comprehensive.

If, however, unanticipated issues arise, the courts should resolve them by reference to the modern law governing rights of counterclaim, and not by reference to what a court of equity would have done before 1873 (the current approach to determining what rights of set-off exist between the parties).

Repeal

9. Section 3 of the *Law and Equity Act* is amended by adding the following Imperial legislation:

2 Geo. II, c. 22
3 Geo. II, c. 27
8 Geo. II, c. 24

The Statutes of Set-off are part of the received law of British Columbia.

When this draft legislation is enacted, they may be repealed.

Section 3 of the *Law and Equity Act* provides that legislation referred to in the schedules in that section is repealed.

Rules of Court

An Order in Council amending the *Rules of Court* should be made under the *Court Rules Act*, R.S.B.C., c. 77.

The *Rules of Court* are amended as follows:

(1) Rule 19(13) is repealed and the following enacted in its place:

Rule 19(13) has been amended by deleting references to rights of set-off.

A defendant in an action may set up by way of counterclaim any right or claim, whether for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

(2) Rule 21(15) is repealed and the following enacted in its place:

Rule 21(15) has been amended by deleting references to rights of set-off.

Where a counterclaim extinguishes the plaintiff's claim, the court may give judgment for the defendant for any balance in his favour or for such other relief as the court thinks just.

Under this Rule, the court may give judgment to the defendant for any balance in his favour after the claim of a successor in interest is extinguished by a cross demand under the draft legislation.

Judgment for the balance will be appropriate where the successor in interest generally represents the estate of the original party who owed the obligation.

If the original party who owed the obligation is insolvent, however, judgment will not assist the obligor very much. He will have to share with other unsecured creditors.

Further changes to the *Rules of Court* are recommended. See Appendix B.

CHAPTER VIII

CONCLUSION

A. Introduction

Following the Judicature Acts, the rules respecting equitable set-off were applied with some flexibility. *Young* v. *Kitchin*[1] and *Government of Newfoundland*,[2] referred to in previous chapters as "classic cases," are actually among the first statements respecting equitable set-off in the light of the reforms introduced by the Judicature Acts. This more liberal view persisted up until *Hanak* v. *Green*,[3] a case now often criticized as adopting too wide a view of equitable set-off.[4]

For several decades, British Columbia courts also approached equitable set-off in keeping with the reforms introduced in the Judicature Acts. In 1915, for example, in *Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*[5] a five member panel of the Court of Appeal held that set-off was equated with rights of counterclaim. Similarly, in 1924, in *Royal Bank of Canada* v. *Gustafson*,[6] rights of set-off and counterclaim were not distinguished.

Recently, English and Canadian courts have approached equitable set-off more strictly. The British Columbia Court of Appeal, for example, in *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.* observed that:[7]

> I do not think that there will be many cases in which a court will allow equitable set-off. The cases will be confined to those where it would be manifestly unjust to refuse the relief.

This observation embodies a view markedly different from that expressed by courts following the enactment of the Judicature Acts. It reflects, in part, the difficulties modern courts have in applying nineteenth century equitable concepts to situations alien to the context in which they were developed.[8] These difficulties may be traced, on the one hand, to the problems of understanding equitable concepts divorced from the procedural law they were designed to overcome and, on the other hand, to the use of a vocabulary derived from legal concepts antiquated even by the nineteenth century.

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[1] *Supra*, Chapter II, n. 6.

[2] *Supra*, Chapter V, n. 27.

[3] *Supra*, Chapter II, n. 7. In 1888, *e.g.*, *Wilson's Practice of the Supreme Court of Judicature*, (7th ed., 1888) 203, observed:

> In the case of pecuniary claims, the power of set-off is no longer, as was formerly the case, limited to debts. Claims for unliquidated damages may now be set off or set up against debts and debts against damages, and damages against damages.

[4] *Supra*, Chapter II, n. 11.

[5] *Supra*, Chapter II, n. 2.

[6] (1924) 33 B.C.R. 379 (S.C.); *see also Stucki* v. *Reed*, (1967) 61 D.L.R. (2d) 351, *rev'd.* but not on this point, (1967) 62 D.L.R. (2d) 535 (B.C.C.A.).

[7] [1985] 6 W.W.R. 14, 29 (B.C.C.A.).

The modern law of set-off is a curiosity. It consists of legal and equitable principles formulated to overcome procedural problems and jurisdictional limitations which were resolved in 1873. The complexities of those principles serve no modern purpose, and obscure the underlying policies of the law to such a degree that they are frequently overlooked by modern courts. Following the Judicature Acts, it appeared that the law of set-off had largely been submerged in rights of counterclaim. More recently, courts have gone back to nineteenth century law to resolve modern problems, and have reinforced the distinctions between set-off and counterclaim. In this process, several important policies, namely that an assignee should be in no better position than his assignor, and that a broad right of set-off is available in situations of insolvency, have been overlooked or forgotten.

B. Summary of the Need for Reform

If we stop for a moment, draw back and look over the history of set-off, we can see patterns emerge. In the seventeenth, eighteenth and nineteenth centuries, until 1873, the cases are scattered. For about fifteen years after 1873, there are a cluster of cases, among which are some of the decisions that today are considered seminal. After that, counterclaim generally replaced the need for set-off.

For most of the first part of the twentieth century, set-off was an insignificant part of the law, and the distinctions between it and counterclaim were largely unexplored.

In 1958, in order to determine an appropriate award of costs, the English Court of Appeal reached into the nineteenth century and selected the law of set-off, dusting it off a bit in the process.[9] Not much was done with it in England until the last fifteen years. Developments in English law usually take several years before their impact on Canadian jurisprudence is felt. The resurgence of cases concerning set-off in Canada began about ten years ago. Part of the resurrection of set-off is likely due to two English decisions: the *Aries Tanker* case,[10] decided by the House of Lords in 1977; and the *Federal Commerce* case,[11] decided by the Court of Appeal in 1978. Each case involved vast amounts of money.[12] The legal research that went into these cases was staggering, the presentation of counsel was brilliant, and the decisions handed down were luminous discourses of the ancient law. Any lawyer, armed with *Hanak* v. *Green*, *Aries Tanker* and *Federal Commerce*, now has what many believe to be the definitive word on the law of set-off.

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[8] The experience in Canada is not unique: Spry, "Equitable Set-offs," (1969) 43 Aust. L.J. 265:

> [Since the Judicature Acts]...there have been a number of cases where these principles appear to have been misunderstood, and the regrettable position has arisen that there are now many conflicts in the authorities, and, moreover, different practices have been established in different jurisdictions.

The House of Lords, in *Aries Tanker*, adopted the view that, notwithstanding that there was little to support the result dictated by nineteenth century precedent, it should be applied. Commerce requires certainty. Nothing would be more disastrous to commerce than to depart from accepted principles of law. This was an unfortunate decision. Counsel had put together a compelling analysis of the nineteenth century case law concerning set-off and the manner in which it should function in the twentieth century.

In *Federal Commerce*, the English Court of Appeal took a less conservative approach. It was said that modern courts should not be tied by pre-Judicature Act authority. The law must be shaped in terms of contemporary needs and policies.

What has happened is that principles of law lay fallow and unchanged for a hundred years, virtually unconsidered by the courts. There is a danger in looking to the law of another time, without an understanding of the circumstances in which it was applied, particularly when it consists of a scattering of threads of incompletely stated principle. Moreover, there is something strange about applying rudimentary procedural principles developed in other centuries to adjust the substantive rights of parties today.

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[9] In *Hanak* v. *Green*, *supra*, Chapter II, n. 7.

[10] *Supra*, Chapter III, n. 8.

[11] *Ibid.*

[12] *Federal Commerce* involved an amount within a bracket of U.S. $6,000,000 to $15,000,000.

If we again look back to the law of set-off applied by the courts before 1873, we can see that the handful of cases from which the modern law is derived can be classed into five streams:

(a) the set-off of debts,

(b) set-off of demands other than debts,

(c) set-off against an assignee in the courts of common law,

(d) set-off against an assignee in the courts of equity,

(e) set-off against a trustee in bankruptcy

Different principles applied in each case and further, more refined levels of classification can be identified. For example, the principles differed depending on whether the cross demands were legal or equitable. To these separate categories of the law of set-off, one must add the abatement cases, and the principles of set-off developed in discrete areas of the law, such as negotiable instruments, freight and distress. For a number of reasons, nineteenth century courts never achieved even a working synthesis of the principles of set-off. The forms of action restricted the development of the law. Each cause of action, and the principles of set-off that were applied, developed separately from other causes of action. The divided jurisdiction of the courts contributed further distinctions to the law of set-off.

The first attempt to fuse the jurisdictions of the courts of common law and of equity, the *Common Law Procedure Act* of 1854, also added confusion to the law. The Act allowed common law courts to recognize equitable defences, such as set-off. The unfamiliarity of the common law judges with equitable principles, and their hostility to this jurisdiction, generated decisions which distorted the law.

The *Judicature Act, 1873* put all of these problems right for a period of almost one hundred years. But that is no longer true. For a variety of reasons, the law of set-off is being raised in an increasing number of cases, for highly subtle purposes. It is being made to serve in situations never contemplated by the nineteenth century and earlier courts that first formulated these principles. Many modern cases involve set-off against a receiver appointed under a floating charge. The floating charge is a security device which was very much a novelty when the *Judicature Act, 1873* was enacted, but which is common today. Nineteenth century principles of set-off were not formulated in cases concerning assignments for security. It is not surprising, consequently, that these principles operate uncomfortably in a modern context. They are being relied upon to perform functions never anticipated by those who originally crafted them.

The refinement of legal principles usually involves a synthesis of related concepts, so that the process tends towards simplification. But this cannot be expected in the law of set-off. The modern law is too much changed since the principles of set-off were established. The attempt to graft them onto the modern law has been unsuccessful. A review of modern cases reveals numerous errors in principle. In *Tuckerr*[13] it is said that mutuality is lost by assignment. This statement is the result of the modern law having forgotten what assignments were and how they were enforced until 1873. In *Aboussafy*[14] it is said that equitable set-off is encompassed by abatement. The court confused principles of the common law with those of equity. In *Touche Ross*[15] it is said that liquidated demands cannot be set-off unless they are related. The court failed to distinguish between statutory set-off and equitable set-off. In *McGee (Irwin)* v. *Irwin*,[16] it is said that the set-off of liquidated demands is only available in equity. The court overlooked the Statutes of Set-Off. In *Brattberg*,[17] the court treated the issues of whether set-off was available, or whether proceedings on the plaintiff's demand could be stayed until the defendant could bring proceedings on his demand, as distinct questions. The court was unaware that equitable set-off, until 1854, operated almost exclusively by restraining proceedings on one demand until proceedings on another could be brought. In *Holt* v. *Telford*,[18] the Supreme Court of Canada endorsed separate rules for the set-off of secured and unsecured debts, without appearing to notice that this is what they had done. In bankruptcy and receivership cases, the courts apply one set of the principles of equitable set-off, oblivious to the fact that these were not the principles equity applied when there was an insolvency.[19] In *Coba*,[20] the court speaks of restricting rights of set-off in order to protect the innocent assignee, contradicting three hundred years of law in which the focus has been the protection of the innocent obligor.

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[13] *Supra*, Chapter II, n. 5.

[14] *Ibid.*

[15] *Ibid.*

[16] (1986) 8 C.P.C. (2d) 86 (Ont. Prov. Ct., Fam. Div.).

[17] *Supra*, Chapter III, n. 6; *see also Re Toronto Apartment Buildings Co. and Gambhir*, (1987) 39 D.L.R. (4th) 444, where a stay was refused in exactly the circumstance which motivated the development of equitable set-off: the court had not the jurisdiction to recognize the claim sought to be set-off; *Greymac Trust Co.* v. *Reid*, (1987) 19 C.P.C. (2d) 134 (Ont. S.C.); *Royal Bank of Canada* v. *Stirskey*, [1988] B.C.D. Civ. 3691-01 (S.C.); *cf.*, *Iraco Ltd.* v. *Staiman Steel Ltd.*, (1986) 54 O.R. (2d) 488 (H.C.) *aff'd*, (1987) 62 O.R. (2d) 129 (C.A.).

[18] *Supra*, Chapter V, n. 1.

Many of the problems that can be identified in the current law are the result of applying precedent from before 1873 in modern cases. The law was fundamentally reshaped in 1873, although not all at once. The procedural reforms introduced by the Judicature Acts cleared the way for rethinking the law. Before 1873, the focus of the law was the separate causes of action that were available. The law drew distinctions based on the particular action involved. When the Judicature Acts provided for one procedure for bringing any action, it allowed the law perspective so that general principles common to a number of related kinds of actions could be observed or deduced. From this period, one can trace the beginnings of the creation of the theoretical structures that underlie the modern law of contract, tort and so on.[21]

Our understanding of the law continues to grow. It cannot be said, however, that the problems posed by the procedural rules that existed before the Judicature Acts no longer restrict the law and our understanding of it. There are many examples, but the best is undoubtedly set-off. The current law requires the courts to peer back to determine what a court of equity would have done before 1873[22]. It is difficult to imagine an exercise more fraught with peril.

Few areas of the law are in so desperate need of re-examination and restatement.

For these reasons we have recommended the enactment of legislation that embodies the principles outlined in Chapter VII of this Report.

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[19] *Supra*, Chapter II, C. "Set-Off When the Parties are Insolvent."

[20] *Supra*, n. 7.

[21] Atiyah, *Pragmatism and Theory in English Law*, (1987).

[22] Theoretically, the courts are compelled to apply those principles which governed equitable jurisdiction before the Judicature Acts were enacted. That was the formulation used to create the "fused" jurisdiction of common law and equity. Nevertheless, other areas of equitable jurisdiction have been modified over the years. Set-off is one of the few areas of the law where the Judicature Act formulation seems to have stultified development. *See, e.g.*, *Colonial Bank* v. *European Grain Ltd.*, [1988] 3 W.L.R. 60, 75-6 (C.A.).

C. Acknowledgments

The Commission wishes to acknowledge the work and assistance of a number of people who contributed to this project.

First, we would like to thank the many people who commented on the Working Paper. The comments and criticisms we received were thoughtful and assisted greatly in the formulation of our final recommendations.

We would also like to express our appreciation to a number of former members of the Commission's legal staff who worked on this project. Allan Perry conducted the initial research for this project. Harbans Dhillon conducted further research and assisted in the technical editing of the Working Paper. Jill Turner performed similar services for the preparation of this Report.

Finally, we would like to acknowledge the contribution of Thomas G. Anderson, Counsel to the Commission. Mr. Anderson, subject to the direction of the Commission, drafted both the Working Paper and this Report.

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APPENDICES

APPENDIX A

Recommended Amendments to British Columbia Legislation

A number of ancillary amendments to provincial legislation are made necessary by the Commission's recommendations concerning set-off. Since the concept of set-off is to be submerged in the procedure of counterclaim, all references in the legislation to set-off in the context of litigation should be deleted. Where legislation speaks of set-off with respect to payments of money, the legislation should be revised to instead refer to "deductions." In this Appendix are all provisions to be found in the British Columbia statute book that refer to set-off. Necessary changes follow the sections. They are denoted by brackets.

The result of this revision will be to remove the term set-off from the statute book, with one exception. Legislation governing the setting off of fireworks will remain intact.

CHAPTER 40

BUILDERS LIEN ACT

Assignment by contractor or counterclaim against him not to defeat lien or trust

18. (1) No assignment by the contractor or subcontractor of any money due in respect of the contract is valid as against any lien or trust created by this Act.

(2) As to all liens, except that of the contractor, the whole contract price is payable in money, and shall not be diminished by any prior or subsequent indebtedness, set off, or counterclaim in favour of the owner against the contractor.

["Set off," should be deleted.]

Enforcement of claim in court

29. (1) Subject to sections 18 (2) and section 20 (6), a claim of lien or liens for any amount may be enforced by action in the court according to the practice and procedure of the court, including third party practice and procedure, except where it is varied by this Act. Where an action is brought to enforce a claim of lien in respect of an improvement made on land in the boundaries of more than one county, the court of one of the counties has full power to enforce the claim of lien for the whole improvement, and the claimant has the right to select the court of any one of the counties in which to bring his action.

(2) On the trial of an action to enforce a claim of lien, the court may hold that the claimant is entitled to a lien for the amount found to be due, and that in the event the amount found to be due is not paid may order and direct the sale of the land, or the improvement, or the materials placed on the land, or the interest of the owner or any of them, and further proceedings may be taken for the purposes mentioned as the court thinks proper, and any conveyance under its seal shall be effectual to pass any estate or interest sold.

(3) A defendant in an action to enforce a claim of lien may set off or set up by way of counterclaim any right or claim arising out of the same transaction for any amount, whether the set off or counterclaim sounds in damages or not, and the court has power to pronounce a final judgment in the same action on the claim of lien, set off and counterclaim.

["Set off or", which appears twice in subsection (3), should be deleted, as should "set off and."]

CHAPTER 54

COMMERCIAL TENANCY ACT

Landlord may apply to registrar of County Court

28. In case a tenant

(a) fails to pay his rent within 7 days of the time agreed on; or

(b) makes default in observing any covenant, term or condition of his tenancy, the default being of a character as to entitle the landlord to enter again or to determine the tenancy, and

wrongfully refuses or neglects, on demand made in writing, to pay the rent or to deliver the premises leased, which demand shall be served on the tenant or on some adult person on the land or, if vacant, be affixed to the dwelling or other building on the land, or on some portion of the fences, the landlord or his agent may apply to the registrar of the County Court within the territorial limits where the land is situate or partly situate, on affidavit

(c) setting forth the terms of the lease or occupancy;

(d) the amount of rent in arrears, and the time for which it is in arrears;

(e) producing the demand made for the payment of rent or

delivery of the possession, and stating the refusal of the tenant to pay the rent or to deliver up possession, and the answer of the tenant, if an answer was made; and

(f) setting forth that the tenant has no right to set off or the reason for withholding possession, or setting forth the covenant, term or condition in performance of which default has been made, and the particulars of the forfeiture;

and on filing of the affidavit, the registrar shall issue a summons calling on the tenant, 3 days after service, to show cause why an order should not be made for delivering up possession of the premises to the landlord, and the summons shall be served in the same manner as the demand.

["Set off" should be replaced by "counterclaim."]

CHAPTER 64

CONSUMER PROTECTION ACT, 1967

Assignee's obligations

17. (1) Subject to subsection (2), the assignee of any rights of a lender in any transaction to which this Part applies has no greater rights than, and is subject to the same obligations, liabilities and duties as, the assignor.

(2) No borrower shall receive from, or be entitled to set off against, an assignee of the lender an amount greater than the balance owing on the contract at the time of the assignment; and, if there have been 2 or more assignments, no borrower shall recover from an assignee who no longer holds the benefit of the contract, an amount that exceeds the payments made by the borrower to that assignee.

["Set-off should be replaced by "counterclaim."]

CHAPTER 65

CONSUMER PROTECTION ACT

Assignee's obligations

3. (1) Subject to subsection (2), an assignee of a right of a lender or seller in a transaction to which this Act applies has no greater right than, and is subject to the same obligations, liabilities and duties as, the assignor respecting the credit given to the debtor.

(2) No debtor shall receive from, or is entitled to set off against, an assignee of the lender or seller an amount greater than the balance owing on the contract at the time of the assignment.

["Set off against" should be replaced by "deduct from."]

Notice requirements

33. (6) A debtor may recover as a simple contract debt, set off or counterclaim any cost of borrowing imposed contrary to subsection (2) or (3) and paid by the debtor.

["Set off" should be deleted.]

CHAPTER 72

COUNTY COURT ACT

Jurisdiction in certain actions

29. (1) Subject to section 28, the County Courts have jurisdiction

(a) in all personal actions where the debt, demand or damages claimed do not exceed $50 000;

(b) in any action where the debt or demand claimed consists of a balance not exceeding $50 000, after an admitted set off of any debt or demand claimed or recoverable by the defendant from the plaintiff;...

["Set off" should be replaced by "deduction or counterclaim."]

Supreme Court may order trial in County Court

56. (1) Where in a proceeding on a contract brought in the Supreme Court the amount claimed by the plaintiff does not exceed $50,000, or where the claim, although it originally exceeded $50,000, is reduced by payment, an admitted set off, or otherwise, to a sum not exceeding

$50,000, either party to the action at any time, if the whole or part of the claim is contested, may apply to the Supreme Court in chambers for an order that the action be tried in any County Court in which the action might have been commenced, or in any County Court convenient to it.

["Set-off" should be replaced by "deduction or counterclaim."]

CHAPTER 79

CREDIT UNION ACT

Lien on shares

40. (1) Notwithstanding anything in this Act, a credit union has a lien on the shares and deposits of a member or other person to whose credit shares or deposits stand on the records of the credit union, together with dividends and interest on them, for any indebtedness due or accruing due to it by the member or other person, or for any obligation in respect of the indebtedness, and the shares and deposits may not be redeemed or withdrawn unless the credit union consents.

(2) Subject to subsection (2.1), a credit union may apply the shares and deposits and dividends and interest on them on which it has a lien or charge to any indebtedness in default, or to any obligation in respect of the indebtedness, without notice to any person, and the exercise of the lien or charge by application of the shares, deposits, dividends and interest does not constitute a realization of security within the meaning of any other Act.

(2.1) A credit union may apply equity shares and declared but unpaid dividends on them on which it has a statutory lien to the indebtedness of a shareholder only in accordance with sections 26, 108, 111, 112 and 117.

(2.2) An equity share shall not be charged to secure a loan made by or an obligation made to the credit union.

(3) For the purpose of subsection (2), indebtedness shall be deemed to be in default where

- (a) an amount of the principal or interest is not paid on the due date; or
- (b) there has been a failure to observe or perform any obligation relating to the indebtedness.

(4) A credit union shall not exercise a lien created by this section by application of shares, deposits, dividends and interest

- (a) where the shares, deposits, dividends and interest are owned jointly, unless all the joint owners are indebted in respect of the indebtedness that is in default; or
- (b) where the shares, deposits, dividends and interest are held by a trustee with respect to indebtedness of
  - (i) the trustee, unless the trustee would have been permitted to charge them as security for the indebtedness; or
  - (ii) a beneficiary, unless the beneficiary or the trustee would have been permitted to charge them for the indebtedness.

(5) A person,

- (a) to the extent he may charge his deposits and interest on them for indebtedness to the credit union; and
- (b) subject to the approval of the board,

may waive in writing a right of set off with respect to the deposits and interest on them.

(6) The approval of the board referred to in subsection (5) is not required with respect to deposits with a central credit union and interest on them.

(7) Unless the credit union approves, shares of the credit union may not be set off against claims made by the credit union in respect of indebtedness to it.

["Set off against" should be replaced with "deducted from."]

CHAPTER 86

CROWN PROCEEDING ACT

Interpretation

1. In this Act

...

"proceeding against the Crown" includes a claim by way of set off or counterclaim raised in proceedings by the Crown, an interpleader proceeding to which the Crown is a party, and a proceeding in which the Crown is a garnishee.

["Set off or" should be deleted.]

Rights of parties and authority of court

11. (3) No person shall avail himself
   (a) of a set off or counterclaim in proceedings by the Crown for the recovery of taxes, duties or penalties; or in proceedings of any nature by the Crown, of a set off or counterclaim arising out of a right or claim to repayment for taxes, duties or penalties.

["Set off or," which appears twice, should be deleted.]

11. (5) No person shall, without leave of the court, avail himself of a set off or counterclaim in proceedings by the Crown, unless the subject matter of either the set off or the counterclaim relates to a matter under the administration of the particular government ministry for which the proceedings are brought by the Crown.

["Set off or" and "either the set off or" should be deleted.]

CHAPTER 98

DRAINAGE, DITCH AND DYKE ACT

Recovery of taxes and fines

129. All taxes and fines may be recovered by and in the name of the commissioners, with costs, as if they were private debts, and a copy of the statement referred to in section 82, or of that part that relates to the particular tax sued for, certified by the Registrar of Titles or other proper officer to be a true copy of the statement deposited in the land title office, is conclusive proof of the levy having been made and of the liability of the owner of the land in question to pay the tax; and no tax or fine shall be subject to set off of a private nature or be joined with any private claim on the part of the commissioners.

["Set off" should be replaced with "deduction or counterclaim."]

CHAPTER 114

ESTATE ADMINISTRATION ACT

Application

95. (6) Section 107 shall for all purposes be deemed to be and to declare the law as in force on and from December 19, 1925, except as to property of an estate set off or assigned as dower to a widow before March 29, 1934.

[No changes should be made, since it concerns the law in force before 1934.]

CHAPTER 15

FINANCIAL ADMINISTRATION ACT

Set-off of amounts owed

34. The Treasury Board may by directive authorize the Comptroller General to retain money by way of set-off, out of any money due or payable to a person by the government or out of a trust fund, where

(a) that person owes money to the government,
(b) an overpayment has been made by the government to that person, or
(c) an advance made to that person under section 32 has not been repaid or accounted for.

["Set off," both in the text and in the heading, should be replaced with "deduction."]

CHAPTER 133

FIRE SERVICES ACT

Order to remedy conditions

22. (1) After an inspection the fire commissioner, or an inspector with his authority, may in writing order that within a reasonable time, to be fixed by the order,

(a) where section 21 (a) applies, the owner remove or destroy the premises, or the owner or occupier repair the premises;
(b) where section 21 (b) applies, the owner or occupier alter the use or occupancy of the premises;
(c) where section 21 (c) applies, the occupier remove or keep securely the combustible or explosive material or remedy the flammable conditions;
(d) where section 21 (d) applies, the owner or occupier remove or take proper precautions against the fire hazard.

(2) The owner, occupier or person in charge shall after the receipt of an order comply with it.

(3) The cost of complying with an order shall, in the absence of an agreement to the contrary, be borne by the owner. Where, on the owner's default, the occupier pays the cost, the occupier has a right of action or set off against the owner for the cost actually and necessarily paid in complying with the order.

["Set off" should be replaced with "deduction."]

CHAPTER 167

HIGHWAY ACT

Compensation for land taken

14. (4) In determining compensation payable to any owner for land entered and taken possession of under this Part, there shall be taken into consideration the increased value, beyond the increased value common to all land in the locality, that will be given to the remaining land of the owner through which the highway will pass, because of passage of the highway through it or because of construction of the highway or works incidental to it, and the increased value shall be set off against the compensation otherwise payable to that owner under this section.

["Set off against" should be replaced by "deducted from."]

CHAPTER 236

LIMITATION ACT

Counterclaim, etc.

4. (1) Where an action to which this or any other Act applies has been commenced, the lapse of time limited for bringing an action is no bar to

(a) proceedings by counterclaim, including the adding of a new party as a defendant by counterclaim;

(b) third party proceedings;

(c) claims by way of set off; or

(d) adding or substituting of a new party as plaintiff or defendant,

under any applicable law, with respect to any claims relating to or connected with the subject matter of the original action.

[Subparagraph (c) should be deleted.]

CHAPTER 290

MUNICIPAL ACT

Costs where compensation does not exceed tender

567. (1) The council, in all cases where claims for compensation or damages are made against it which, under any Act, are declared to be subject to arbitration in the event of the parties not being able to agree, may offer in writing to any person making a claim an amount it considers proper compensation for the damage sustained or land taken, together with interest at the rate of 6% a year. If the claimant does not accept the amount so offered and the arbitration is proceeded with, then if an award is obtained for an amount not greater than the amount offered, the costs of the arbitration and award shall be payable by the claimant to the municipality and set off against any amount awarded against it. If the arbitration award is a greater sum than the amount offered, or if no offer in writing has been made and compensation is awarded to the claimant, the costs of the arbitration including the costs of the claimant, shall be borne by the municipality. All costs shall be taxed by the registrar or district registrar of the Supreme Court for the judicial district in which the land is situate. Every award made under this Division bears interest at the rate of 6% a year until payment.

["Set off against" should be replaced by "deducted from."]

Apportionment of cost

791. (7) Revenue attributable to a function shall be set off against its cost.

["Set off against" should be replaced by "deducted from."]

CHAPTER 53

NATURAL GAS PRICE ACT

Sale of natural gas by corporation

5. (6) The portion of the corporation's cost of service payable under subsection (2) by a producer in respect of a volume of natural gas sold under subsection (1) by the corporation may be recovered by the corporation as a debt due, and the corporation may set off that portion of the corporation's cost of service and any money owing to the corporation under subsection (1) against money payable to the producer out of the fund.

["Set off" should be replaced with "deduct." "Against" should be replaced by "from."]

CHAPTER 298

NEGILGENCE ACT

Provisions governing awarding of damages

2. The awarding of damage or loss in every action to which section 1 applies shall be governed by the following provisions:

(a) the damage or loss, if any, sustained by each person shall be ascertained and expressed in dollars;
(b) the degree in which each person was at fault shall be ascertained and expressed in the terms of a percentage of the total fault;
(c) as between each person who has sustained damage or loss and each other person who is liable to make good the damage or loss, the person sustaining the damage or loss shall be entitled to recover from that other person the percentage of the damage or loss sustained as corresponds to the degree of fault of that other person;
(d) as between 2 persons each of whom has sustained damage or loss and is entitled to recover a percentage of it from the other, the amounts to which they are respectively entitled shall be set off one against the other, and if either person is entitled to a greater amount than the other, he shall have judgment against that other for the excess.

["The amounts to which they are respectively entitled shall be set off one against the other, and" should be deleted.]

Apportionment of liability for costs

3. Unless the court otherwise directs, the liability for costs of the parties to every action shall be in the same proportion as their respective liability to make good the damage or loss. The provisions of section 2 governing the awarding of damage or loss apply, with the necessary changes and so far as applicable, to the awarding of costs, with the further provision that where, as between 2 persons, one is entitled to a judgment for an excess of damage or loss and the other to a judgment for an excess of costs there shall be a further set off of the respective amounts and judgment shall be given accordingly.

["There shall be a further set off of the respective amounts and judgment shall be given accordingly" should be replaced by "the person entitled to the greater amount shall have judgment against the other for the excess."]

CHAPTER 314

PAWNBROKERS ACT

Surplus and set off

19. (1) Where a pledge pawned for more than $5 is sold and appears from the pawnbroker's book to have been sold for more than the amount of the loan and profit due at the time of sale, the pawnbroker shall, on demand, where the demand is made within 3 years after the sale, pay the surplus to the holder of the pawn ticket, the necessary costs and charges of the sale being first deducted.

(2) If on the demand it appears from the pawnbroker's book that the sale of a pledge or pledges has resulted in a surplus and that within 12 months before or after that sale the sale of another pledge of the same person has resulted in a deficit, the pawnbroker may set off the deficit against the surplus, and is liable to pay the balance only after the set off.

["Set off the deficit against the surplus, and is liable to pay the balance only after the set off" be replaced by "deduct the deficit from the surplus, and is liable to pay the balance only after the deduction." "And set off" should be deleted from the heading.]

FIRST SCHEDULE

FORMS OF BOOKS AND DOCUMENTS

...

Within 3 years after sale the pawner may inspect the account of the sale in the pawnbroker's books, on payment of 5 cents, and receive any surplus produced by the sale. But deficit on sale of one pledge may be set off by the pawnbroker against surplus on another.

...

["Set off by the pawnbroker against" should be replaced by "deducted by the pawnbroker from the."]

CHAPTER 354

RAILWAY ACT

Increased value of remaining land to be considered

55. The arbitrators or the sole arbitrator, in deciding on the value or compensation, shall take into consideration the increased value, beyond the increased value common to all land in the locality, that will be given to any land of the opposite party through or over which the railway will pass, by reason of the passage of the railway through or over that land, or by reason of construction of the railway, and shall set off the increased value that will attach to that land against the inconvenience, loss, or damage that might be suffered or sustained by reason of the company taking possession of or using that land.

["Set off the increased value that will attach to that land against" should be replaced by "take into consideration the increased value that will attach to that land when assessing the."]

CHAPTER 15

RESIDENTIAL TENANCY ACT

Amount of security deposit

15. (1) A landlord shall not

- (a) impose a requirement that a security deposit be given except at the time the tenancy agreement is entered into, or
- (b) require or receive a security deposit in an amount exceeding the equivalent of 1/2 of one month's rent payable under the tenancy agreement.

(2) Where a landlord receives a security deposit in excess of the amount permitted under subsection (1), the tenant may set off the excess amount against all or part of the rent due from him.

["Set off the excess amount against" should be replaced by "deduct the excess amount from."]

15. (5) A tenant may, with the consent of the landlord, set off all or part of a security deposit and the accrued interest, if any, on it against all or part of the rent due from him.

["Set off all or part of a security deposit and the accrued interest, if any, on it against" should be replaced by "deduct all or part of a security deposit and the accrued interest, if any, on it from."]

Unlawful rent increase recovery

19. (1) A landlord or his agent shall not demand, collect or attempt to collect a rent increase other than in accordance with section 18.

(2) Where a rent increase is collected other than in accordance with section 18, the rent increase paid by the tenant

- (a) may be set off against all or part of the rent due from the tenant, or
- (b) is recoverable by the tenant.

["Set off against" should be replaced by "deducted from."]

CHAPTER 370

SALE OF GOODS ACT

Interpretation

1. In this Act
"action" includes counterclaim and set off;

["And set off" should be deleted.]

True owner

66. (3) This Act does not prevent the owner of goods sold by an agent from recovering from the buyer the price agreed to be paid for the same, or any part of that price, subject to any right of set off on the part of the buyer against the agent.

["Set off" should replaced by "counterclaim."]

CHAPTER 387

SMALL CLAIM ACT

Removal into County Court

5. (1) Where the debt or damages claimed in an action brought in the court amounts to $300 or more, and it appears to the County Court of the county where the defendant resides or carries on business that the case should be tried in the County Court, and the County Court by order so directs, the action may be removed from the court into the County Court on terms as to costs previously incurred or other terms as the County Court making the order thinks fit, and all proceedings shall be transferred by the Court to the registrar of the County Court.

(2) The County Court may also in a similar manner remove into the County Court an action in which the defendant claims a set-off or counterclaim for debt exceeding $2000, or sets up a counterclaim for damages exceeding $2000.

["Set off or" should be deleted.]

Particulars of claim

14. (1) A person applying for a summons shall, before it is issued, file the particulars of demand, setting out the debt or damages claimed. The particulars shall be stated in, or a copy of them shall be annexed to, the copy of the summons served on the defendant.

(2) Every defendant having a set-off or desiring to set up a counterclaim shall promptly, after service on him of the summons, file particulars of the set-off or counterclaim, and serve a copy of it on the plaintiff.

["Having a set-off or" and "of the set-off or" should be deleted.]

Set-off

29. (1) Debts due from the plaintiff to the defendant before the action is brought may be set off against the plaintiff's claim; but if a set-off is based on an instrument having a penalty, then only the debt secured by the condition shall be set off.

(2) If the set-off established is equal to or more than the debt due to the plaintiff and the excess does not exceed $2,000, the defendant shall have judgment for the excess.

(3) If the set-off established is less than the debt due to the plaintiff, the plaintiff shall have judgment for the difference.

(4) Where the defendant's claim exceeds the debt due to the plaintiff by more than $3,000, the defendant is entitled to set off an amount equal to the amount of the plaintiff's claim, and may proceed to recover the residue in any court of competent jurisdiction, unless he abandons so much as will reduce the excess to $3,000.

(5) In a proceeding brought by a personal representative or trustee, the defendant may set off any demand due him from the testator or the intestate. Where a set-off is established, the judgment shall be against the plaintiff in his official capacity and is evidence of the debt, but no execution shall issue on it.

[Subsections (1) - (4) should be repealed and not replaced. Subsection (5) should be repealed and replaced by

"Counterclaim"

(5) In a proceeding brought by a personal representative or trustee, the defendant may raise by counterclaim any demand due him from the testator or the intestate. Where the counterclaim is established, the judgment shall be against the plaintiff in his official capacity and is evidence of the debt, but no execution shall issue on it."]

Counterclaim

30. (1) A claim and counterclaim may be tried and determined at the same hearing. If the counterclaim established is equal to or more than the amount of debt or damages found due to the plaintiff, and the excess does not exceed $3,000, the defendant shall have judgment for the excess. If the established counterclaim is less than the amount found due to the plaintiff, the plaintiff shall have judgment for the difference.

(2) Where the counterclaim established exceeds the amount found due to the plaintiff by more than $3,000, the defendant is entitled to have set off an amount equal to the amount found due the plaintiff, and may proceed to recover the residue in any court of competent jurisdiction, unless he abandons so much of his counterclaim as will reduce the excess to $3,000.

(3) At the hearing the court may order the costs to be paid or set off between the plaintiff and defendant as it considers just.

[Subsections (2) and (3) should be deleted and replaced by

"(2) Where the counterclaim established exceeds the amount found due to the plaintiff by more than $3,000, the amount found due to the plaintiff is extinguished and the defendant may

(a) recover judgment for the excess if he abandons so much of his counterclaim as will reduce the excess to $3,000; or
(b) proceed to recover the excess in any court of competent jurisdiction.

(3) At the hearing the court

(a) shall, if the defendant's counterclaim extinguishes the plaintiff's claim, make one order of costs in favour of the defendant;
(b) may, if the defendant establishes his counterclaim, but it does not extinguish the plaintiff's claim, order the costs to be paid between the plaintiff and defendant as it considers just."]

Failure of judgment creditor to appear

44. If the judgment creditor does not appear at the hearing, the court may award the judgment debtor or garnishee a sum of money by way of compensation for his trouble and attendance, to be paid promptly without any right of set-off. The court may enlarge a judgment summons as it thinks fit.

["Set-off" should be replaced by "deduction."]

CHAPTER 428

WAREHOUSE RECEIPT ACT

Interpretation

1. In this Act
"action" includes counterclaim and set-off;

["And set-off" should be deleted.]

CHAPTER 436

WOODWORKER LIEN ACT

Contents of statement

4. The statement shall set out briefly the nature of the debt, demand or claim, the amount due to the claimant, as near as may be, over and above all legal set-offs or counterclaims and a description of the logs or timber on or against which the lien is claimed, and may be in the form in Schedule A, or to the like effect.

["Set-offs" should be replaced by "deductions."]

CHAPTER 437

WORKERS COMPENSATION ACT

Compensation not assignable or liable to attachment

15. A sum payable as compensation or by way of commutation of a periodic payment in respect of it shall not be capable of being assigned, charged or attached, nor shall it pass by operation of law except to a personal representative, nor shall any claim be set off against it, except for money advanced by way of financial or other social welfare assistance owing to the Province or to a municipality, or for money owing to the accident fund.

["Set off against it" should be replaced by "deducted from it."]

APPENDIX B

Recommended Amendments to the Rules of Court

Creditor failing to attend, etc.

42.(35) If the creditor who issued a subpoena fails to appear at the hearing, or if the examiner is of the opinion that the proceedings are unnecessary, or vexatious, the examiner may order the creditor to pay to the person subpoenaed a sum of money by way of compensation and may order that sum to be paid forthwith or to be set off against the debt. (s. 152, *County Courts Act*; r. 57, County Court Rules, 1968.)

[Replace "set off against" with "deducted from."]

37.(17) Where the plaintiff proceeds with an action and recovers an amount equal to or less than the amount paid into court,

(a) he may tax his costs reasonably incurred up to delivery to him of a copy of the notice under subrule (7) and, provided the notice was delivered at least 7 days prior to the commencement of the trial, the defendant may tax his costs reasonably incurred after delivery of the notice to the plaintiff; but if the notice was delivered less than 7 days prior to the commencement of the trial, the costs of any steps taken by the parties subsequent to delivery shall be in the discretion of the court, and

(b) the amount paid in shall be applied in satisfaction of the plaintiff's judgment after set-off of the defendant's costs, if any, and any balance shall be repaid to the defendant. (New.) [am. B.C. Reg. 467/81, s. 11.]

[Replace "set-off" with "the deduction."]

Defendant proceeding after payment in

37.(19) Where the defendant proceeds with his third party proceeding and recovers an amount equal to or less than the amount paid into court,

(a) he may tax his costs reasonably incurred up to delivery to him of notice under subrule (7), and provided the notice was delivered at least 7 days prior to the commencement of the trial, the third party may tax his costs reasonably incurred after the delivery of the notice to the defendant; but if the notice was delivered less than 7 days before the commencement of the trial, the costs of any steps taken by the parties subsequent to that delivery shall be in the discretion of the court, and

(b) the amount paid in shall be applied in satisfaction of the defendant's judgment after set-off of the third party's costs, if any, and any balance shall be repaid to the third party. (New.) [en. B.C. Reg. 18/85, s. 10.]

[Replace "set-off" with "the deduction."

Set-off of costs

57.(10) Where a party entitled to receive costs is liable to pay costs to another party, the registrar may tax the costs he is liable to pay and may adjust them by way of deduction or set-off or may delay the allowance of the costs he is entitled to receive until he has paid or tendered the costs he is liable to pay. (O. 65, r. 27, reg. 21.)

[Delete "or set-off."]